"THE COMPANIES ACTS":

A COURSE OF LECTURES

BY

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LECTURES

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PREFACE.

VERY few words are needed to commend these Lectures to the careful and earnest attention of the student.

MR. CLAUSON is a nephew of MR. H. B. BUCKLEY, Q.C., and was associated with him in the latest edition of his standard work on *The Companies Acts*. In these Lectures, MR. CLAUSON has shown that he possesses a happy combination of lucidity of style with simplicity of language.

A subject which has hitherto presented a formidable appearance to the actuarial student, bristling with technical difficulties and intricate points of law, has now been made an easy and interesting study.

H. W. M.

"THE COMPANIES ACTS."

FIRST LECTURE.

I.—Introductory.

GENTLEMEN, the President and Council of your Institute have done me the honour of requesting me to deliver to you a series of six lectures upon the Companies Acts, with special reference to the questions which you, as officers of Insurance Companies, are likely to meet with in your daily practice. There are several points on which I should like to warn you at the start; and the first warning I must give is, that you must not expect to find these lectures in any sense interesting. Company law is composed of a large amount of detail, and mere detail, though very important, is, I am afraid, rarely interesting. But I hope that, before the six lectures have come to a conclusion, I shall have been able to give you a certain insight into some of the principles which lie at the bottom of this confused mass of detail: and when you have some knowledge of the principles, you may find the detail rather more interesting than, I am afraid, it is likely to prove on first acquaintance. Then there is another point on which I must warn you. You are not, and do not intend to become, professional lawyers, and so in this course of lectures you will expect from me, and I shall be able to give you, only a mere outline of the matters with which we are going to deal. There is a proverb, which often comes home to lawyers, that a little knowledge is a dangerous thing: in these lectures I

shall hardly be able to impart to you enough knowledge to be really dangerous; but still I must warn you that there are so many pitfalls and difficulties in connection with companies, that it is dangerous to suppose that you have a firm grasp of the subject until you have had many years of practical experience of it.

Now that I have warned you as to what you must not expect from me, let me tell you shortly how I propose to deal with the matter in hand. In the first place, I shall ask you to join with me in what I may call a historical retrospect. I shall ask you to go back with me in imagination to the early part of the eighteenth century. We shall find that the practice of commercial combination was then in its infancy. Companies are merely one of the forms which commercial combination takes. By commercial combination I mean the conjunction in one commercial adventure of a number of individuals. We shall find that at the beginning of the eighteenth century the commercial world was beginning to realize the truth—a mere commonplace to us—that, in many matters of commerce, the combination of individuals in some form or other is absolutely essential. We shall find that English law slow, far slower then even than now, to adapt itself to changing circumstances, threw difficulties, grave and serious difficulties, in the way of effectual combination. I shall ask you to follow me in a rapid survey of the conflict which continued during the century between, on the one hand, the pushing and progressive man of commerce, eager to combine with other capitalists, or other adventurers, and on the other hand, the slow and conservative lawyer, loth to see any changes in the somewhat elaborate machinery to which he was used. The reason why I ask you to join with me in this historical retrospect is, that company law, like most other English institutions, is of slow growth; and in order to understand many of its remarkable features, it is absolutely essential that you should know, to some extent at least, the causes which gave rise to it, and the various incidents that it met with in the course of its growth. Our survey will soon bring us to the beginning of this century, and it will end in the year 1862, when The Companies Act was passed, which, for our purposes, we may regard as the code of existing company law. Since then, company law has been developed by judicial decision, and has been amended by various Acts of

the Legislature; but all these developments and amendments have not substantially altered the main body of the structure. For our purposes we may regard the year 1862 as the year in which company law was practically fixed in its present condition.

In the subsequent lectures, I shall ask you to follow me through the details of the Acts. In our second lecture we shall consider how to form a company, and we shall review shortly the various questions which arise upon the formation of a company. As to this I may say that you are not likely ever to have to form a company yourselves: but unless you know what the processes are which have to be gone through for that purpose, you will find it very difficult to grasp the exact nature of the concern which results from those processes. The subject of the third, fourth, and fifth lectures will be the management and administration of companies; and in those lectures we shall have to consider a number of details which will come home to you more forcibly than the matters with which we shall deal in the first two lectures; for we shall have to consider various questions which crop up in everyday practice. The sixth lecture will be devoted to considering winding-up, re-construction, and amalgamation. Now probably you are, or will be, connected with very flourishing concerns, the members of which would be struck with horror at the very suggestion of any of their officers having anything to do with re-construction and winding-up. However, we lawyers have found, as the doctors have found, that we can learn more from the dead body than the living body; and our post-mortem examinations of companies in a state of decay are very often far more instructive than the consideration of the state of companies while they are flourishing. And there is one more matter, which gives a certain importance to these questions from your point of view, and that is, that if you ever have anything to do with amalgamation, or, in other words, with the swallowing-up, so to speak, of minor or decaying companies, you will find that you will then encounter some of the most difficult questions, from a legal point of view, which you will ever, as actuaries, have to face.

I must also add this. The lectures are on the Companies Acts, but I propose also to deal, incidentally, with the Life Assurance Companies Acts, which, from a lawyer's point of

view, form quite a separate code. I shall deal with these Acts only incidentally, and as appendices to the Companies Acts. I quite admit that from your point of view the details of the Life Assurance Companies Acts are exceedingly important; but, from the point of view of principle, I do not know that they are quite so important. We shall consider their various provisions mainly in the course of the lectures in which we deal with management and administration. There is one further point that I must mention. Connected with company law are various branches of law of great intricacy and great interest. I refer particularly to the law relating to friendly societies, building societies, and industrial and provident societies. Very probably you may have to deal with some of these societies in the course of your experience; but I do not propose to say anything about them in these lectures. The law relating to them is very complicated, and I do not think I should do you any service if I attempted to give you what would only be a mere summary of the difficult points concerning these societies. As it is important in lectures of this kind to deal with the matter in hand as simply as possible, I shall not even mention these societies again.

After these preliminary remarks, I will now ask you to consider the main topic of this first lecture, and to glance with me rapidly over the history of company law from the beginning of the eighteenth century to 1862. Our aim is to discover what were the legal difficulties in the way of commercial combination which had to be met by the evolution of modern company law, and what, in outline, were the various devices by which it was endeavoured to meet these difficulties.

At the opening of the eighteenth century there were two ways, and practically only two ways, in which a number of individuals could join for purposes of trading in combination with a community of capital and interests. First, they might form a partnership; secondly, they might join in a petition to the Crown, and obtain a charter turning them into a corporation, that is to say, incorporating them. I am not going in detail into the law of partnership, or the law of corporations; but I must ask you to attend to me very carefully while I tell you, as shortly as possible, the chief advantages and the chief disadvantages attending each of these forms of combination. The importance of the matter is, that the history

of the development of company law is nothing more nor less than the history of the various attempts to invent and legalize a form of combination involving, so far as possible, the advantages both of a partnership and of a corporation, without the inconveniences attaching to either. Perhaps almost every provision in the constitution of a modern company might be traced back to an attempt to secure an advantage or avoid an inconvenience belonging to one of the older forms of combination. When we have grasped exactly what these respective advantages and inconveniences are, we shall be in a position to follow each step in the development of Company law with an intelligent appreciation of its meaning and its effects.

We will deal with partnerships first. Now, according to English law, there is, in a sense, no such thing as a partnership as distinct from the individual members. Suppose, for instance, that A, B, and C join together as partners and trade as A. & Co. No doubt each individual partner, when he is speaking of any of the property of the firm, will say: "This ship"—it may be—"is not mine, it is partnership property; I do not own it, the partnership owns it." In the same way, when speaking of any debt, he would say: "It is owing, not to me, but to the partnership." That is the popular way of speaking of a partnership; but the law takes a different view. In the view of the law there is no such thing as a partnership as a legal entity, distinct from the separate partners. The property of our hypothetical firm of A. & Co., is the property of A, B, and C, the individual partners; and the debt, in the same way, is not owing to A. & Co., but to A, B, and C, the individual partners. As this is very important, let me give you a concrete example. I do not know whether you are aware that a British ship can only be owned by British subjects. Suppose, in our hypothetical firm of A. & Co., that C, the junior partner, is a foreigner. The effect of that is that the firm of A. & Co. will not be able to own a British ship, for if they do, A, B, and C, will be the owners of the ship; and that is not allowable, since C is a foreigner. Now contrast this with the position of an incorporated body. Take, for instance, this Institute of yours, which is an incorporated Institute. The property of the Institute is not the property of the various members. The Institute is, as a matter of law, a separate body from the members. This hall in which we are is, you

may say, the property of the Institute, but you individually, although you may be members, have no ownership in it whatever. Suppose, now, that the Institute wishes to own a British ship, and assume for the moment, contrary, no doubt, to the fact, that it is within its objects and powers to do so; but assume, further, that some of its members are foreigners. This does not matter at all. The ship will be owned by the Institute, which is a British Institute, and the fact that some of the members are foreigners is immaterial, as they individually will have no property in the ship. This illustration will, I hope, enable you to grasp the difference there is between an unincorporated partnership and an incorporated body.

To make the matter a little clearer, let me give you another example, which comes home to partners every day. Suppose that A & Co. owe me £100, and I bring an action against them, and get judgment, and my debt is nevertheless not paid. What are my rights? My rights are to send the Sheriff to levy execution upon the property of my debtors, and sell enough goods to raise my £100. Suppose that A & Co. are brokers in Throgmorton Street, and that C owns a private house at—say—Streatham. I can order the Sheriff to seize C's furniture at Streatham. Now, if the firm had been a separate legal entity, and I had recovered judgment against it, I could have seized the firm's office furniture in Throgmorton Street, but I could not have touched C's furniture at Streatham, as that is his private property, and has nothing to do with the firm. Another remarkable result flows from this principle of the identity of the firm and the partners. Every creditor of the firm being a creditor of each individual partner, it is very difficult for a partner who leaves the firm to get free of his liability for the debts incurred by the firm of which he was a partner. Of course, he can arrange with his co-partners, when he retires, that they will satisfy all the liabilities of the firm; but such an arrangement as that is not binding on the creditors of the firm. There is nothing to prevent a creditor, who became a creditor while the retired partner was still a partner, from enforcing his debt against the property of the retired partner. I need not say that, from the point of view of the ordinary investor, this is exceedingly awkward. Suppose that the London and Westminster Bank, instead of being a company, were a partnership; and that the

provisions of the law of partnership applied to it; and that I had a share in it; and that I sold my share. It would be exceedingly awkward if, after I had sold my share, a creditor of the London and Westminster Bank could descend on me, and levy execution on my furniture at my private house. From the point of view of the investor that effect of the partnership law is obviously very unpleasant and onerous.

There are two other points that I should mention in connection with partnerships. First, each partner is an agent for all his co-partners in any matter relating to partnership business. If he incurs a debt on behalf of the partnership within the scope of the business, his co-partners are bound by it. If he sells any of the partnership property, even although he may have been forbidden by his co-partners to sell it, or to sell it at that particular price, still the transaction is binding, and the purchaser can keep the property, provided, of course, that the purchaser had no knowledge of the restriction to which the partner is subject. The second point is that a new member cannot be introduced into the partnership without the consent of all the partners, unless there is some special provision to the contrary in the partnership deed. The reason for this is that the relations between partners are very intimate, and they are very dependent upon one another. Hence, but for some special agreement to the contrary, any partner is entitled to object to being forced to enter into these intimate relations with a person of whom he does not himself fully approve, or in whom he has not unquestioning personal confidence.

Let me sum up the chief disadvantages of a partnership. In the first place, each member is liable for all the debts of the firm. In the second place, each member is a part owner of all the property of the firm. In the third place, each member can, within the scope of the business, incur liabilities on behalf of the firm, so as to render all the partners liable. In the fourth place, it is difficult for a retiring member to cut himself free from his partnership liabilities. And in the fifth place, a new member cannot be introduced into the firm without the consent of all the partners, unless there is some special provision to the contrary in the partnership deed. But it is only fair that I should point out certain advantages which attend a partnership. Partnerships are usually constituted by some agreement in writing or deed, and in that deed provisions can

be inserted to render the rights and liabilities of the partners, as between themselves, as elastic as they please, so long only as the partners do not attempt to go outside the scope of the partnership business. Later on, when we come to consider companies, and how far the construction of a company is elastic, you will appreciate the importance of what I have just told you. In a partnership the elasticity of its constitution is unlimited as between the partners. It can be altered by agreement between the partners to any extent, subject to this —that the partners must keep within the four corners of what is called the scope of the partnership business. Let me give you an example to explain what the scope of the partnership business means. Suppose that I am one of five partners in a grocery business. Now, although the partnership deed may give three of the five partners the power to override the other two, yet the three partners cannot by a majority decide to start the business—say—of company promoting as a branch of the partnership business, if the business which it was agreed to carry on was merely that of a grocer.

Now, let us turn from partnership to the other form which, as I told you, commercial combination could take at the beginning of the last century. That form was incorporation by Royal Charter. Now, according to the common law of England, the Crown can incorporate any persons and any number of persons by charter, and can so make them into a corporation. I shall not try to define what a corporation is, because I think you probably have a sufficiently clear idea of what I mean by the expression. The essence of a corporation, in the legal point of view, is that it is a new and separate legal entity, a new and separate legal person, different from the individuals that constitute it; it is a permanent and undying body. Take, for example, the Bank of England. How many times has the body of proprietors been renewed? But still the Bank is the same body as it ever was—the same, not only in popular estimation but in law. The Bank is an example of a corporation. Let us come nearer home. Take this very Institute. Your Council changes, your old members die, new members come in; but the Institute is the same all the time. It buys property in 1888; without any alteration of any sort or kind, legal or otherwise, it holds the same property in 1898. If it retains the property, the position in 1998 will be the same as it is now; the same body will hold the

same property in the same way. Turn back for a moment, and contrast this with the position of a partnership. A, B, and C are partners, and buy a house out of their partnership moneys. In the course of years A, B, and C die, and new partners come in. Thirty years after, the partners, continuing the old firm in a sense, and carrying on the business under the same name of A & Co., are P, Q, and R. The house was formerly owned by A, B, and C; it is now owned by P, Q, and R. The name of A & Co. is unchanged; everything else is changed; the owners are different persons. That is the great point of contrast between a partnership and a corporation.

Let us take another point of contrast between a partnership and a corporation. A new partner could not, as we found, ordinarily be introduced into a partnership without the consent of all the partners. When once a man is a partner, he cannot, without delay and difficulty, cut himself off from his liabilities to creditors. A member of a corporation is in a very different position. The conditions under which a new member can be admitted will depend on the provisions of the incorporating charter, and we need not stop to consider this in detail; but when it comes to a question of leaving the corporation the matter is simple. The liabilities to creditors will not prevent the member from cutting himself adrift; and why? The creditors are not creditors of the member, they are creditors of the corporation. They look for payment to the corporation, and not to the member; to the property of the corporation, not to the property of the member. It is obvious what a difference this makes to the member—a difference, at first sight, all in favour of the member. But, as a matter of fact, it has been found that the difference is, in a sense, too favourable to the member; he has more freedom than his interests really demand. The member of a corporation, at common law, is under no liability whatever. The accession to the corporation of a wealthy member is no increase to the corporation's commercial credit. It is quite indifferent, so far as the credit of the Bank of England is concerned, whether its proprietors are paupers or millionaires. A man dealing with the Bank of England knows that he is dealing with an institution which has a certain amount of property, and it is absolutely immaterial to him what the private property of the member is. Contrast that with the position of the London and Westminster Bank, which is not a

corporation in the same sense as the Bank of England. Every member of the London and Westminster Bank is under a certain liability. In case the London and Westminster Bank were to come to grief, the members would be liable to make contributions—contributions which would in each case be of limited amount, but still considerable contributions—to the funds of the bank. The effect of this is to enhance the credit of the bank enormously, because not only do persons who deal with the London and Westminster Bank deal with a body owning a certain amount of property, but they deal with a body which has this great advantage, that, in case anything goes wrong, large contributions will come into the till from the members. The moral of it is that it is not always advantageous that members should be entirely free from liability.

There is another advantage in a corporation that I must mention, though time will not permit of my going into the historical causes of the existence of this advantage. It is, that a corporation, having, of course, no physical existence, can act only through agents; and that the members of the corporation are not, *ipso facto*, its agents, as the members of a partnership are agents of their co-partners. A corporation can only be bound by acts done by or under the authority of its governing body, acting in the name of the corporation, and using, at all events on all occasions of importance, the corporation seal.

And now let me sum up what I have said as to the main advantages of a corporation over a partnership. They are summed up by saying that a corporation is a legal entity, a separate person. From this flows certain advantages: first, that the members are not liable to the corporation's creditors; secondly, that the members are not co-owners of the corporation property; and, thirdly, that the members of the corporation are not, *ipso facto*, agents of the corporation.

You will now want to know what is the disadvantage which attaches to a corporation, and why it is that the commercial world has not been content to accept combination in the form of a corporation as a satisfactory expedient. The answer is short, and might seem weak to a foreigner, but to an Englishman it appeals at once. It is this. In order to combine in the form of a corporation it is necessary to obtain a Royal Charter. What does this mean? Of course it means delay and cost. But it means more than that. It means that

you must satisfy the Crown officials that the adventure which you are going to start is one worthy of recognition and assistance by the Crown. As a matter of fact, commercial men have come to the conclusion that, however valuable a Crown charter may be if you have to incorporate a hospital, or start a semi-political body, such as the East India Company (though I am afraid that here we are on rather debateable ground), still incorporation by Royal Charter is not fit for the ordinary commercial venture. We all know that Crown officials, and especially permanent officials, are generally rather deficient in the quality to which commercial men attach a very great importance, and which in the slang of the day may best be described by the word "push", and consequently in their estimate of the advantages or possibilities of particular commercial adventures, their views are not always in sympathy with the views of the men of commerce.

If I have succeeded in making my meaning clear, you are now in a position to realize exactly what the problem was which confronted our commercial ancestors at the beginning of the eighteenth century, and which found its solution, or at all events, a solution, in the middle of the nineteenth century, when the great system of modern Company law, which we are going to consider in our later lectures, finally took a definite shape. For a moment let us consider the conditions which brought the problem to light. The seventeenth century had been a century of strife, religious and political, twice breaking out into actual civil war. The natural accompaniment was a disordered currency and disorganized communications. Towards the end of the century came the rule of William III, who was a strong man, a statesman whose family traditions and foreign training led him to realize the importance of economic soundness. At the beginning of the eighteenth century the country found itself in security at home, respected, and even powerful abroad, and with the greatest of commercial blessings, a sound currency. Commercial opportunities at once became greater than individuals could exhaust. The crying want of commercial men was the power of combining small capitalists and individual adventurers, so as to cope with the new commercial opportunities. Let me state the problem as it then presented itself. The problem was, to discover a form of combination which would combine the advantages of a partnership with those of a corporation. The required

association had, as far as possible to possess the following characteristics: First, it must be formed without the aid, or at all events without the necessity of obtaining the approval, of any State official. Secondly, it must be as easy as possible for the members to join and leave it; to put it technically, the shares must be transferable, and, so far as possible, with transfer of a share liability to pay a corresponding share of the liabilities of the adventure must come to an end. Thirdly, as far as possible, the property and the liabilities must be made the property and liabilities of the association and not of the members; the association must be, if not a corporation, at all events as near an imitation of a corporation as possible. Fourthly, individual members must be debarred from binding their co-adventurers; in other words, the members must be mere investors, and not directors or partners. Fifthly, the liability of each member must, so far as possible, be capable of being limited either to his share in the common stock of the company, or, at all events to the sum, whatever it might be, that he might be prepared to risk in the particular adventure.

Now let me tell you what, in fact, happened, and what lines commercial combination took. In the first place, officials had to be avoided, and hence the required association had to be a partnership; therefore commercial men combined themselves to form large partnerships, which were usually called companies. Secondly, the shares had to be transferable. As between members there was not much difficulty in this, because in their partnership deed they could provide that the shares should, as far as possible, be transferable. As regarded outside creditors the question, at that time, could not be solved. Business men had to make the best of the position, and a person who took shares in a company had to hope that, after he left the company, it would fulfil its liabilities, and its creditors would have no need to trouble him for the payment of the company's debts. In connection with this, a method of limitation of liability was invented, which I shall stop to consider for a moment, because it is of considerable interest to all who have dealings with insurance companies, as it is still employed to some extent even to this day. When a company enters into a contract there is no difficulty in saying, "We "will enter into this contract with you on these terms; if we "become liable to pay you, the payment shall be made out of

"the common stock or fund of the company: you shall not "look to any of the members to satisfy the company's "liability to you." An insurance company, of course, carries on practically the whole of its business by entering into contracts, and therefore finds no difficulty in limiting its liability by this expedient. But take the case of a company whose business does not consist merely of entering into contracts. Take, for instance, an omnibus company. There is no reason why an omnibus company should not, through its properly authorized agent, the conductor, or by means of a notice indorsed on the omnibus ticket, or otherwise given to the passengers, say to its passengers: "We will "carry you so far for such a fare: but any accident or "damage you may sustain shall only be compensated out of "the company's common fund; you shall not go against the "members of the company." That does very well as far as the passengers are concerned. But suppose that the driver of an omnibus drives wildly, runs into a cart, and damages the carter. The carter will bring an action against the company for the damage he has sustained; he will probably get heavy damages, and the company will have to pay them. Now, by no possible contract can the company guard its members from liability to meet damages so incurred. Judgment goes against the company, and the company has to pay; and if the company does not pay, then, if it is merely a large partnership, the members would have to pay.

To come back to the thread of our discourse. The third characteristic which, as we found, was required in a successful form of combination did not offer any great difficulty. It was, you will remember, that so far as possible the property and liabilities of the association had to be made the property of the association and not of the members. This could be done, as regards property, by vesting it in trustees—that is to say, in persons who, as regards the outside world, would for many purposes be treated as absolute owners, while they would simply be acting on behalf of the members. I have already dealt with the question as regards the liabilities of the association, and I will say no more on this head. Then, fourthly, comes the difficulty that in an ordinary partnership each partner can bind the others, and deal with the property of the partnership. Now, this difficulty was not found to be a very formidable one, for the reason that persons dealing with

these large partnerships or companies found it impossible to deny that they knew that, practically, the business of such companies could not be carried on on the terms of every member acting on behalf of the partnership; and that, practically, the business must be, and was, carried on by governors, directors, or managers. This practically solved this particular difficulty, for, as I told you, if an outsider dealing with a partner knows that, as between the partner and his co-partners, the right of the partner to bind the partnership is restricted, the outsider is in effect bound by the restrictions, and cannot hold the partnership bound by any arrangements which the particular partner was not authorised to carry out.

What, then, was the position at the beginning of the eighteenth century? Commercial association took the form of large partnerships, which, from the legal point of view, were very much the same as ordinary partnerships. But there were certain disadvantages about them, and one was that these partnerships or companies found it difficult to enforce legal rights against persons with whom they had dealings. The difficulty arose from a purely technical cause. If a company wished to bring an action—as its members were, in the eye of law, merely partners in a large partnership, and not members of a separate corporate entity—it was necessary for the whole of the members to join in the action. Now, consider the difficulties of the situation. A large company wants to sue a recalcitrant debtor on a cheque or bill of exchange. The company has, perhaps, five hundred members. To bring an action in which five hundred persons are to be plaintiffs is obviously all but impracticable. Great difficulties arose from this, and I will tell you later how the difficulty was got over. A further difficulty which we must not forget was that there was no limit to the liability of members, at all events in the case of a company which did not carry on its business entirely by entering into contracts.

Now, you will probably be disposed at this point to think that, after all, the large partnerships or companies which we have been talking about were very much like the companies with which we are familiar at the present day; and you will want to know how it is that company law has taken a century-and-a-half to develop into its present form. The step from a large partnership or company of that kind to a modern

company is not a very long one, except in time. The reason why the step was not taken at once, and quickly, was due to nothing so much as to the gullibility of the public. This, I must tell you, is a factor which no company lawyer can afford to neglect. The formation of companies, or rather, as I have explained, of large partnerships with readily transferable shares, was, of course, the opportunity of the small investor, and attracted a large amount of capital from a widely extended class of persons. The usual result followed. The demand for investments was met by a supply of companies, and naturally the supply was not always of a satisfactory description. The fraudulent promoter soon became as familiar as he is now, and the natural consequence was a series of panics, into the details of which I do not propose to enter, but which ended in the bursting of the South Sea Bubble. It seems pretty clear to us, looking back from the height of modern experience, that the gullibility of the public was at fault. But that was not the view generally taken at the time. The Legislature, in its wisdom, came to the conclusion that the terrible effects of the panics were due to the existence of companies with transferable shares. It does not seem to have occurred to the Legislature that the difficulties into which investors found themselves plunged arose from their own gullibility. The Legislature, attributing, as it did, these difficulties to the existence of large partnerships with transferable shares, tried to meet the situation by passing, in the year 1719, an Act since commonly known as the Bubble Act. I do not propose to tell you in detail what this Act provided. It was a fertile source of litigation for nearly a century. Its effect was to place certain restrictions upon the formation of large partnerships with transferable shares, and the practical effect of these restrictions was, that nobody knew when and how far a partnership with transferable shares was legal, and when and how far it was not. Large partnerships or companies fell into disrepute; lawyers began to be afraid of them—commercial men soon learn to distrust any institution at which lawyers take fright—and, practically, company enterprise came to a standstill.

Towards the middle of the eighteenth century company enterprise gradually revived, and it revived in a very curious way. One would think that the building of canals would have very little to do with Company law, but it is to a great extent

due to canals that Company law has taken its present form. About the middle of the eighteenth century the Legislature came to the conclusion that it was advisable to establish inland communication by means of canals. In order to build a canal you must get together a large amount of capital, and further you must come to the Legislature for special powers. The reason for requiring special powers is, that you cannot do without the power of taking compulsorily the land on which you are going to dig your canal. If you do not possess that power any obstinate landlord, through whose estate you wish to carry the canal, could refuse to sell you any of his land, and the result would be that your canal project would come to an end. It was necessary, therefore, for the promoters of canal undertakings to come to the Legislature for compulsory powers; and at the same time they obtained powers from the Legislature to form themselves into companies in such a form as best to attract investors; and the form adopted was naturally that of companies with transferable shares. The immediate effect upon the prospects and development of ordinary commercial companies was not, perhaps, very great, but the gradual effect was that the community in general, and especially the lawyers and the Legislature, became used to the working of these large companies with transferable shares, and began to see that, after all, there was nothing peculiarly monstrous about companies of this kind, whatever horrors the framers of the Bubble Act might have attributed to their existence. Gradually the Legislature reconciled itself to assisting ordinary company enterprise, and the form that its assistance took was a peculiar one.

It became the practice towards the latter part of the eighteenth century for the large partnerships or companies, which were mainly banking and insurance companies, to come to Parliament for special Acts to give them the power to sue and be sued by a particular officer. I must ask you to notice the importance of this. Such acts got rid of what, you will remember, was a great stumbling block in the way of the unincorporated companies—the difficulty they had in enforcing their legal rights. It was very important, indeed, for them to get the right of suing in the name of an officer. Very likely some of you may be familiar with this, for there are still some insurance companies in existence that pursue the old practice of suing in the name of an officer, although they

are now-a-days diminishing in number. Towards the end of the eighteenth and the beginning of the nineteenth centuries applications for powers of this kind became frequent, so frequent that, in the year 1826, a general Act was passed, which enabled certain favoured companies, formed to carry on banking business, to obtain this privilege without coming to Parliament. The scheme of the Act was that this privilege should be enjoyed on condition of making periodical returns to the Stamp Office, and of paying certain fees. In the year 1834 these privileges were extended, and any company was 1824?
able to obtain the privilege, but only on the condition that it satisfied the officers of the Crown that it was a bona fide concern, whose objects were objects that deserved encouragement by the State. As you will see, this does not carry us very far; for it is of the essence of a satisfactory form of combination from the point of view of a commercial man, that he shall be enabled to obtain privileges without satisfying the Crown officers that his adventure deserves encouragement. However, a step in the right direction had already been taken in 1824, for in that year the Bubble Act, or at least the main part of it, was repealed. That cleared the ground, and in 1825 a new departure was made, by enabling the Crown to incorporate companies by charter, and make the members liable for the debts of the company, which could not be done before. This step was followed, in 1837, by the Act of that year, by which the Crown was enabled, by letters patent, to create companies with limited liability. But you will notice that all the Acts which I have mentioned at present simply empower the Crown to act, except as regards banking companies, and we are still far away from freedom.

In the year 1844, a decisive advance was made. It was in this year that freedom began to assert itself. In that year an Act was passed which enabled any company to obtain the benefits of incorporation by simply going through certain formalities and registering certain documents. This, of course, was an enormous advance in the direction of freedom, because, for the first time, commercial adventures were able to obtain all the advantages of incorporation without having to cope with any interference from Crown officials. From the year 1844 onwards the crop of company legislation becomes thicker and thicker, and amending Acts follow one another closely.

I do not propose to go through the details of them, but I shall ask you to pass with me at once to consider in outline what occurred in 1862.

In 1862, the Companies Act of that year was passed, and I will tell you shortly the main features of it in regard to the points that we have touched upon in this lecture. The Act enables any seven persons, by registering certain documents and paying certain fees, to form themselves into a company —into an incorporated company—with the object of pursuing any lawful objects which they specify in the registered documents. I must ask you to remember the number 7, as there is a certain amount of magic about it, as we shall find later on. The privilege of incorporation is, in effect, the same privilege as could be obtained by Crown charter; but any projected company can take advantage of the Act, provided only that it wishes to pursue lawful objects. It does not matter, as far as the Act is concerned, what the objects are, provided they are lawful. Now, let me point out shortly the effect of this. The effect is that any body of commercial adventurers can at once obtain incorporation. The property of the concern is the property of the incorporated body, and not of the members; and no alterations among the members affect the property in the least: the cumbrous and expensive machinery of trustees becomes unnecessary. Then the debts and liabilities of the company are the debts and liabilities of the incorporated body, and not of the individual members. As far as the outside creditors are concerned, individual members are free from liability. But in the Act of 1862 there is what was practically a new departure, though it had been anticipated to some extent by some of the Acts passed between 1844 and 1862. The member is freed by incorporation from liability to the creditors, but is made liable to the corporation in the event of winding-up. The company can be so constituted, by inserting proper provisions in the registered documents, as to make the members either liable to meet all the liabilities of the concern (in which case the concern becomes an unlimited company), or liable to meet the liabilities up to a certain limit (in which case the company becomes a limited company). The member is in the same position as the member of a corporation at common law, in being absolutely free from liability to the creditors; but he becomes liable to the company, liable to fill up the company's

pocket for the benefit of the creditors, either without limit or with a limit.

Companies constituted under the Act of 1862 borrow from the old incorporated partnerships the feature of the liability of the members to satisfy the debts of the company, though under the Act the liability is indirect and not direct. They borrow from the same source another feature of very great importance. You will remember that I told you that in a partnership the partners are quite free to make any arrangements they please as between themselves, and that they can, if they please, alter the constitution of their partnership to any extent, provided they keep within what is called the scope of the partnership business. Now, the scheme of the Act of 1862 is similar. It, in effect, binds down companies incorporated under its provisions to pursue only the objects stated in their registered documents at the date of their incorporation, subject to certain exceptions with which, for the moment, we need not trouble ourselves. A company under the Companies Acts cannot do anything beyond what is stated or implied in the objects which it registered when it obtained incorporation. To do anything beyond this is beyond its powers, or, to use the technical legal phrase, is "*ultra vires.*" Anything within the powers of the company is "*intra vires,*" anything beyond the powers of the company is "*ultra vires.*" Later on we shall have to consider what the consequences of an act being *ultra vires* are; but, practically, it is true to say that any act which a company or its officers profess to do which is *ultra vires,* is, so far as the company is concerned, just the same as if it had not been done at all. It is a mere nullity. It may render the officers of the company liable: that is a question we shall consider later. But so long as a company keeps within its objects, so long as it only does that which is *intra vires,* its constitution, according to the Act of 1862, is as elastic as it pleases. By taking the proper steps, and by passing the necessary resolutions, practically any of the regulations of the company can be altered. The effect is that the constitution of a company under the Act of 1862 is widely elastic, so far as internal affairs are concerned; but the company is rigidly bound down to the particular objects specified in the documents registered at the time when it was incorporated.

Before we part this evening, let me sum up very briefly

the substance of what I have told you. I pointed out to you the problem which confronted commercial men at the beginning of the eighteenth century, the problem of how to combine the advantages of partnership with those of combination in the form of a corporation. We saw that what was wanted was some form of combination, (first) which could be attained without the necessity of satisfying a Crown official as to the merits of the adventure, (secondly) under which it would be easy for a member to get into the adventure and cut himself adrift from the adventure, (thirdly) under which a member's liabilities as debtor and rights as a property owner should be matters to be settled between himself and the company, and not between himself and the outside public, (fourthly) in which individual members should be debarred from binding their co-adventurers, in which, in fact, they should be investors and not directors, (fifthly) in which the liability of each member should be capable of being limited. We considered the difficulties which prevented the immediate solution of the problem, and after glancing very rapidly at the history of successive attempts to solve the problem, we found that for our purposes the solution had been discovered in the Companies Act of 1862.

The next time that we meet I shall ask you to consider with me in detail the mode in which a company is formed under the Act of 1862, and to glance at some of the various questions which arise in connection with the promotion and formation of a company. You will probably find it useful to read the text of Parts I, II, and VII of "The Companies Act, 1862." The Act is printed in the appendix to Sir Nathaniel Lindley's book on Companies, in the appendix to Mr. Palmer's *Company Precedents*, and in the appendix to Mr. Palmer's new book entitled *Company Law*. The latter work I should strongly recommend to anyone who wishes to go at all deeply into company law; it contains a very convenient conspectus of the law, though there is a great deal of matter in it with which, for your purposes, it is unnecessary for you to concern yourselves. I will not ask you to read any commentary on the Act, but merely to read the text of such parts of the Act as I have mentioned.

"THE COMPANIES ACTS."

SECOND LECTURE.

II.—Formation of Companies.

WHEN I last had the pleasure of addressing you we considered the causes which necessitated modern company law, and the problems which modern company law was designed to solve. We found, to put the matter very shortly indeed, that a modern company is an attempt to provide a method of combination for commercial ends which will have all the flexibility and adaptability of a partnership with the advantages attending incorporation. Our task, on the last occasion, was historical and introductory. This afternoon we will devote ourselves to considering how a company is formed. I do not mean to forget that you are not likely yourselves, ever to have to take part in the actual formation of a company; but this does not absolve you from the necessity of acquainting yourselves with the mode in which companies are, in fact, formed. I shall add a few words towards the end of this lecture on the subject of promotion, and I shall also deal shortly with a few points connected with prospectuses.

In the first place, let me read you what I may call the text of my discourse to-day, namely, Section 6 of "The Companies Act, 1862." That Section is as follows:—

> "Any seven or more persons associated for any lawful
> "purpose may, by subscribing their names to a

> "Memorandum of Association, and otherwise
> "complying with the requisitions of this Act in
> "respect of registration, form an incorporated
> "company with or without limited liability."

This Section, you will notice, is not really complete in itself. The words "otherwise complying", &c., obviously send us to other parts of the Act to find out the other requisitions that are to be satisfied before incorporation can be obtained. But the Section comes to this, that any seven persons by signing a document called the Memorandum of Association and registering the document, can, *ipso facto,* form themselves into an incorporated company. For the moment I will only make this comment. You remember that incorporation could, at all events down to well on in this century, only be obtained by Royal Charter, or by a Private Act. The effect of this Section is to enable incorporation to be obtained without expense or trouble by any seven persons associated for any purpose, provided the purpose is a lawful one. As to these latter words we need not trouble much; for although companies are incorporated for all kinds of objects, it is very rarely that the Registrar suggests that the objects of a proposed company are not lawful. For the moment we will pass over Sections 7 to 13, and I will draw your attention to the 14th and 16th Sections. The important part of the 14th Section, reading it shortly, runs thus:—

> "The Memorandum of Association may . . . . . .
> "be accompanied, when registered, by Articles
> "of Association signed by the subscribers to the
> "Memorandum of Association and prescribing
> "such regulations for the company as the
> "subscribers to the Memorandum of Association
> "deem expedient."

We can pass Section 15 for the moment. Section 16 prescribes that the Articles of Association are to be stamped in a particular way and executed in a particular way, and that when they are registered they shall bind the company and the members thereof to the same extent as if each member had subscribed his name and affixed his seal thereto, and had covenanted to conform to the regulations contained in the articles. Then Section 17 provides that the Memorandum

and Articles are to be delivered to the Registrar of Joint Stock Companies, who is to register them, and that certain fees are to be paid. Then Section 18 is very important. It is the Section which practically effects one of the main purposes of the Act.

Section 18 runs thus :—

> "Upon the registration of the Memorandum of "Association and of the Articles of Association ". . . . . . the Registrar shall certify "under his hand that the company is incor-"porated, and in the case of a limited "company that the company is limited: the "subscribers of the Memorandum of Association, "together with such other persons as may from "time to time become members of the company, "shall thereupon be a body corporate by the name "contained in the Memorandum of Association, "capable forthwith of exercising all the functions "of an incorporated company, and having per-"petual succession and a common seal, with power "to hold lands, but with such liability on the part "of the members to contribute to the assets of the "company, in the event of the same being wound "up as is hereinafter mentioned. A certificate of "the incorporation of any company given by the "Registrar shall be conclusive evidence that all "the requisitions of this Act in respect of regis-"tration have been complied with."

Let us see shortly the effect of these Sections. You must have seven persons to form the company. They must be associated for a lawful purpose. Any lawful purpose will do. They have to bring to the Registrar, signed, a document called a Memorandum of Association, and, usually, a second document called the Articles of Association. These documents are registered, and the Registrar makes out a certificate of incorporation. From the moment that the Registrar makes out this certificate the company is in existence as a corporate body. No charter, no approval by officers of the Crown, nothing of that sort is necessary. The company is a corporation. The certificate of incorporation is conclusive evidence of the incorporation, and, though a mistake may have

been made in some detail, still the certificate is good. If the Act applies at all, the certificate is conclusive.

The first comment that will rise in your minds will be this: "I see that the company has now the advantage of being a "corporation. But has it succeeded in getting the advantages "which a large partnership would have had? And, in the "first place, does it possess that elasticity of constitution "which, as we were told, is one of the greatest advantages of "a partnership?" You will remember that the large partnerships or companies formed in the last century and at the beginning of this century were usually regulated by a deed; that the deed was freely alterable within certain limits; that the limits of alterability were fixed by this—that no alteration of the deed could force any partner to join in any adventure outside the scope of the business for which the partnership was originally formed. The memorandum takes the place, so to speak, which was taken in the old companies by the "scope of the business." The "scope of the business" fixed a limit to the alterability of the deed. In the same way the memorandum fixes a limit to the alterability of the objects of the company. The articles which accompany the memorandum can, as we shall see later, be altered; and, indeed, can be altered very freely—and in this respect the articles correspond to the old deeds. But the memorandum is unalterable, and anything outside the memorandum, any object which is not included in the objects stated in the memorandum, is outside the power of the company: it is "*ultra vires.*" You will remember that, in the last lecture, I used, and to some extent explained, the terms "*ultra vires*" and "*intra vires.*" Any act which is outside the objects of the company stated in the memorandum is "*ultra vires*", and must, for all practical purposes, be treated as a nullity. Now, of course, companies can only act through their officers; and that is how a company, although it has no power to do an "*ultra vires*" act, does sometimes find itself doing it, or rather, to put the matter more correctly, the officers of the company sometimes find themselves, ostensibly in their capacity as officers of the company, committing an "*ultra vires*" act—that is, an act which the company cannot do. I need not now enlarge upon the consequences of such an act, for we shall have to consider the consequences when we come to consider the internal management of companies. It is sufficient to say that the consequences of an officer of a

company doing an act which is "*ultra vires*" of the company, is that he ceases, for the purposes of that act, to be an agent of the company, and that anything he does is done on his own responsibility. Let me give you an example to show you how serious this may be. Suppose that it is *ultra vires* for a company to borrow more than £50,000, and that it has borrowed £50,000, and that the directors go to a lender and borrow another £20,000. Although they intend to borrow on behalf of the company, they may very likely find that the effect is that they will have to pay the £20,000 out of their own pockets. As the company could not borrow the £20,000, the company cannot be asked to pay it. It is not the company's debt at all, and if anybody has to pay, it must be the directors; and this is a result which the directors are not likely to welcome.

I will now ask you to go back with me to the Sections which we have passed over, and I will run through them very shortly. The seventh Section of the Act is an important one, as it deals with the limitation of liability. The provisions of it are as follows:—

> "The liability of the members of a company formed "under this Act may, according to the Memo- "randum of Association, be limited either to the "amount, if any, unpaid on the shares respectively "held by them, or to such amount as the members "may respectively undertake by the Memorandum "of Association to contribute to the assets of the "company in the event of its being wound up."

I am afraid you will find that Section, for the moment, a little unintelligible; but we shall come back to the substance of it later. Section 8 tells us what is to be put in the memorandum of a company limited by shares, and, roughly, it comes to this:—First, you must state in the memorandum the name of the proposed company, with the word "limited" as the last word in the name; this is a matter of very great importance; you will find that normally every limited liability company has the word "limited" as the last word in its name; secondly, you must state the part of the United Kingdom, whether England, Scotland, or Ireland, in which the registered office of the company is proposed to be situate; thirdly, you must state the objects of the proposed company;

fourthly, comes a declaration that the liability of the members is limited: and, fifthly, you must state the amount of the capital.

Section 9 tells us what is to be inserted in the memorandum of a company limited by guarantee. I will take this opportunity of saying a word or two about companies limited by guarantee, as I do not propose to say much about them in my other lectures. There are two forms of limiting liability: it may be limited by shares, or it may be limited by guarantee. I will explain by a simple example the difference between these two forms of limitation. Suppose the capital of a limited company to be £1,000 divided into 100 shares of £10 each, every shareholder of that company is, or has been, liable in one way or another to pay £10 in respect of each of his shares; but he has never had any further liability. A company limited by guarantee has no capital in that sense; it has no nominal capital; it is a company in which each member undertakes to contribute a certain sum to the assets of the company in case of winding-up. Each member contributes an equal sum. Companies by guarantee have been a good deal used of late years for the purpose of forming clubs and institutions of that kind, especially golf clubs. For that purpose they are very useful, because the club has all the benefits of incorporation, and in case things go wrong there is, in winding-up, a fund to fall back upon. Usually the guarantee is small, perhaps 10*s.* or £1 per member. Limitation of liability by guarantee is also occasionally used for mutual insurance companies, the arrangement being that the members of the company are the persons who are the holders of participating policies, and of course the holders of non-participating policies would usually not be members. Practically, the formation of a company of that kind is a convenient way of sharing out the profits amongst the holders of participating policies. For the purpose of these lectures I shall treat companies limited by shares as being the ordinary class of limited company, as, for commercial purposes, limitation of liability by guarantee may be disregarded, and we need not trouble ourselves with such companies in detail.

Section 10 of the Act need not detain us; it tells us what is to be put in the Memorandum of Association of an unlimited company. With unlimited companies I do not propose to deal at all, for they are really of comparatively

little interest now-a-days. One of the greatest advantages of incorporation under the Act of 1862 is, that it enables liability to be limited; and incorporation with unlimited liability, though sometimes useful for private trading concerns, is practically little used: naturally anyone who wishes to go into a speculation on a large scale is likely *prima facie* to prefer to have his liability limited.

Section 11, again, need not detain us now; it tells us how the memorandum ought to be executed and attested, and so forth.

Section 12 provides for the alteration of the Memorandum of Association of a limited company in respect of capital by changing the denomination of the shares, and by increasing the capital, and by converting the capital into stock. We shall have to deal with these subjects later, and I will not stop to discuss them now. But the last clause of Section 12 is important, and provides that, save in certain respects there mentioned, "no alteration shall be made by any company in the conditions contained in its Memorandum of Association." You must impress this upon your minds, that for all practical purposes the Memorandum of Association, at all events as regards the objects stated in it, must be regarded as something absolutely unalterable, subject however to this, that, as I shall show you in a moment, certain restricted changes were made in the year 1890 in the law as to the alterability of the Memorandum of Association. Section 13 enables companies to change their names. I will not stop to consider this, as it is not, for our purposes, a matter of much importance. But I will ask you now to listen to some of the clauses of Section 38. This Section is an exceedingly important one, for this reason, that it is on this Section that the liability and the limitation of the liability of members of a company, under the Act of 1862, depends. Section 38 starts by providing that in the event of a company being wound up every present and past member shall be liable to contribute to the assets of the company to an amount sufficient to pay the debts of the company and the cost of winding-up, and such sums as may be required for adjusting the rights of the contributories amongst themselves. So far, every member of a company under the Act of 1862, is liable, in the event of a winding-up, to pay the debts of the company; but the first part of the Section is happily followed by very large qualifications.

The first qualification is contained in the first three sub-sections and comes to this, that a past member is only liable to contribute to the debts of the company if he has ceased to be a present member within one year of the winding-up; the effect of which, of course, is that if a member has transferred his shares and left the company, he is, when a year has passed without a winding-up, quite clear of all liability whatever happens. If the company goes into winding-up in the course of the year, he may be under a liability. The first three sub-sections of Section 38 tell us what liability he will be under. As a matter of fact, the liability is small, because it is only a liability which comes into being if the present members of the company (that is, the persons who are present members of the company at the time it goes into winding-up) are unable, by their own contributions, to discharge the debts of the company. The liability, therefore, is rather the liability of a surety than the liability of a principal. Sub-section 4 is an important one for our purpose. It provides that "in the case of a company limited by shares no contribution "shall be required from any member exceeding the amount, if "any, unpaid on the shares in respect of which he is liable." Let me explain, by a simple example, how this works. Suppose that in a company limited by shares you hold a £10 share; in any case, your liability is limited to the £10: if you have paid £4 on the share, your liability is limited to the amount unpaid, that is, to £6. That is the effect of that sub-section. Sub-section 5 deals with a company limited by guarantee and limits the liability to the sum which the member has undertaken to pay. Sub-section 6 provides that nothing in the Act shall invalidate any provision contained in any policy of insurance or other contract whereby the liability of individual members is restricted, or whereby the funds of the company are alone made liable in respect of such policy or contract. I have already spoken of the effect of such provisions, and this sub-section merely preserves that effect. Then there is one more Section, to which I will draw your attention before I sum up the effect of the sections with which I have been dealing, and that is Section 3 of the Life Assurance Companies Act of 1870. That Section imposes a restriction upon the absolute liberty which is given by the Act of 1862 for the formation of companies; the restriction is, that no company is to be

formed to carry on the business of life assurance in the United Kingdom until the promoters of the company have deposited the sum of £20,000 in Court; the £20,000 is not to be returned to the company until the life assurance fund has been accumulated out of premiums to £40,000. This Section is of some practical importance to you as officers of insurance companies, though I believe I am not wrong in saying that it is regarded, in some quarters, as not going quite as far as is necessary for the protection of the public.

I told you that the Memorandum of Association was to be regarded as for all practical purposes unalterable, but that a change was made in regard to this in the year 1890. Absolute unalterability was found very inconvenient for this reason. A most important part of the memorandum is the clause which defines what the objects of the company are to be. *Prima facie*, one would suppose that the objects of most companies could be stated in short language, and in a very few lines; and, as a matter of fact, that seems to have been the view which the draughtsman of the Act of 1862 took. If you will look in the second schedule of the Act of 1862 you will find certain forms of Memorandum of Association. Form A is an example of the Memorandum of Association of a company limited by shares. The company is to be called "The Eastern Steam Packet Company, Limited", and the object clause runs as follows:—"The objects for which "the company is established are, the conveyance of passengers "and goods in ships or boats between such places as the "company may from time to time determine, and the doing all "such other things as are incidental or conducive to the "attainment of the above object." You notice that the object clause runs to only four lines. If you will take up the memorandum of any company in which you may happen to be interested you will probably find that the object clause runs, not to four lines, but to something like four pages. The reason is this. When a man sat down to draft the Memorandum of Association of a company he had to think not merely what the main business of the company was to be, but what were the various things that it might possibly be convenient or useful for the company to undertake. Take for example the Steam Packet Company, whose memorandum we have just looked at in the schedule to the Act. It was to authorize them to run steam-boats between such places as the

company might determine. But suppose that the directors found that, for the convenience of their passengers, it would be useful to build a waiting-room in which their passengers might wait or store their luggage; and suppose that the directors asked the solicitors of the company whether there was any objection to the company erecting such a building; the solicitor would probably answer that there was a very serious question whether this was within the powers of the company at all. The company can run its steamers from one place to another; but running steamers is after all not the same thing as building a waiting-room. And yet the directors, looking at the matter from a commercial point of view, might well think that the building of a waiting-room would be exceedingly advisable in the interests of the company and of its passengers. This example will suggest to you the kind of reasons which led to the extraordinary elaboration of object clauses in Memoranda of Association. If a promoter were forming a company to carry on a large grocery business, he would not, in a commercial sense, be wise, if he failed to take in the memorandum power to do the innumerable things which firms such as Whiteley's or Spiers & Pond, in fact do or could profitably and conveniently do.

The idea of the Memorandum of Association Act, 1890, was to limit the object clauses in memoranda, by enabling companies, in proper cases, to enlarge their objects by coming to the Court and getting the sanction of the Court. The law now is that a memorandum of association, as it stands, is unalterable; but that if you come to the Court, and you bring yourself within the words of the Act of 1890, which enable the object clause of a memorandum to be enlarged under certain circumstances, with the details of which I need not trouble you, you can get your object clause enlarged by the Court. It must be remembered that the object clause is not enlarged until you obtain the order of the Court.

While I am mentioning the Act of 1890, I must mention a matter which is of considerable importance to a great many old-established companies—a matter which is dealt with rather incidentally in that Act. You will remember that I told you that the old companies formed in the last century and the beginning of this century were usually constituted by a deed of settlement. A deed of settlement was usually—I think I should be right in saying that it was always—a document

of most extraordinary elaboration. Articles of Association, according to modern practice, are, no doubt, somewhat cumbersome documents; but they are expressed fairly tersely, and they are filled with what we lawyers call "common forms." This means that a great many of the clauses in the Articles of Association of different companies are, for all practical purposes, identical. This, of course, is exceedingly convenient in practice, because, if any question arises as to the meaning of any particular article, you will probably find that some other company with a like article has had the same question before. Possibly the question may have been determined by the Court, or has, at all events, been discussed among company lawyers. One thing that the Act of 1890 enables a company to do is this: an old company formed with a deed of settlement can go to the Court and have its deed of settlement swept away, and a memorandum of association and articles of association substituted for it. That has been done in a great many instances in recent years by a large number of banks and by several insurance companies.

When we were considering the Section which prescribes what must be inserted in the Memorandum of Association of a company limited by shares, we found that there were five things to be inserted. First of all, the name of the company. We need not trouble about that. Secondly, the location of the registered office of the company. The object of inserting that is, simply in order that it may be clear on the face of the memorandum what Court has jurisdiction to wind up the company. If the registered office of the company is in England, the winding-up Court is the English Court; if in Scotland, the Scotch Court; and if in Ireland, the Irish Court. The third requisite is a statement of the objects, and with this we have already dealt. The fourth requisite is a declaration that the liability of the members is limited, and the fifth is a statement of the amount of the capital.

Now, the question of the liability of a member of a limited company must be looked at under two heads. First of all, there is his liability while the company is a going concern; and, secondly, there is his liability when the company is being wound up. Now, as far as the Act is concerned, you will not learn anything as to the liability of the member while the company is a going concern, and for this reason: while the company is a going concern, a member is not liable in any

way to anybody outside the company. The company is a corporate body, incorporated under the Act; and, as I told you, a member of a corporation is not liable for the debts of the corporation, and there is nothing in the Statute of 1862 which makes him liable so long as the company is a going concern. A member of a company is liable, however, to the company under arrangements between himself and his fellow members contained in the Articles of Association. It is almost invariably provided by the articles that calls can be made upon the member while the company is a going concern to the extent of the liability on his shares; but that is liability to the company and not to anybody outside the company. The members, so long as the company is a going concern, are quite free from any liability to outsiders.

But what is the position when a company goes into liquidation? We find what the position is then from Section 38, which we considered just now. If a company goes into liquidation, a member's liability is unlimited, except in so far as it is stated to be limited in the memorandum. Hence, in a company limited by shares, each member is liable in winding-up to pay at the outside only the nominal value of his shares; but he is not, as a rule, even liable for as much as that. Let me give you an example. We will take a company with £10 shares, with provisions in the articles enabling calls to be made upon the members. While the company is a going concern, the directors make calls to the extent of, say, £6 on each share, and the members pay up their £6, and the company then goes into liquidation. To what extent is each member liable? He is not liable for £10. His whole share is £10; he has paid £6, and so he remains only liable for £4. He is liable for the difference between the amount called up and the nominal value of his share. Suppose that while the company is a going concern the whole of the £10 has been paid up, and that the company then goes into liquidation. Each member who holds a £10 share would *prima facie* be liable for £10; but, since the whole of the £10 has been paid up, he is not liable for anything. As a matter of fact, you will find, in the vast majority of companies, that at a very early period in their career the whole of the capital is called up; and the effect of this is that a limited company

under these conditions is not a company in which the liability of each member is limited—it is a company in which no member has any liability at all, so that the expression "a limited liability company" is, in a sense, a misnomer. It may, however, interest you to know that almost all, if not all, of the large London Joint Stock banks are in the position of not having fully paid-up shares. They are in the position of having shares on which there is a liability, and in almost all cases it is provided by their constitution that part of that liability (usually known as the reserve liability) cannot be discharged except in winding-up. The effect of this is, that a member of such a bank is liable to a comparatively small amount for calls made by the directors while the company is a going concern, but he is liable to a larger amount when the company goes into liquidation. But, as I said before, this is not the case in most companies; and in the vast majority of companies you will find that the shares are paid up at an early period in the company's life, and thenceforward the member is under no liability at all.

I must say a word on the subject of mixed liability. The Companies Act of 1867 contains a provision that the Memorandum of Association of a limited company may contain provisions making the liability of the directors unlimited. You will see what the object of this is: it is to have a limited company in which the ordinary member shall be a person with limited liability—a mere investor—but in which the active members, the directors, shall be under unlimited liability. The idea is to give a company the benefit of the credit of those persons most actively concerned in its operations. The idea was suggested by the French practice of having partially limited partnerships, called partnerships "*en commandite.*" But it is a system which has never been popular in England. I believe I am right in saying that not half a dozen companies have been registered since 1867 with mixed liability. It is, perhaps, interesting to mention it, if only for the reason that you will find that when amateurs make suggestions for the alteration and improvement of company law, sooner or later, they are sure to suggest the introduction of mixed liability.

While on the subject of liability I must remind you of the form of limitation of liability with which many of you are familiar in daily practice, and which, as we have seen, is

unaffected by the Act. I refer, of course, to the practice that many insurance companies follow, of issuing policies in which the person entitled to the policy agrees that the policy money shall be payable only out of the common fund or common stock of the company. At present only, I believe, a minority of the large insurance companies have availed themselves of the facilities for limiting liability offered by the Companies Acts. But as the number of insurance companies limited under the Acts increases (and the number, I should suppose, will tend to increase), this plan of limiting liability by special provisions in the policies will gradually, I imagine, fall into disuse, though at present it is very common.

There is a further matter in the Memorandum of Association with which we have not yet dealt, and it is a matter of very great importance—namely, the capital. The word capital has caused numerous difficulties to the company lawyer, but for the purposes of the Section with which we have been dealing the word is not very difficult to understand. Suppose that you are anxious to form a company of imposing proportions. You may register it with a capital of, say, £1,000,000. The only objection to registering it with a capital of £1,000,000 rather than with a capital of £100 is, that the Legislature has seen fit to impose a stamp duty on the nominal capital of companies registered under these Acts. The duty is an *ad valorem* duty, and if you are so ambitious as to put your capital at £1,000,000, you have to pay accordingly. But, save for this duty, there is no reason why anyone forming a company should not call its capital £1,000,000 just as soon as £100. If a millionaire tells you that he has a capital of £1,000,000, what do you understand him to mean? You understand him to mean that if he realized all his wealth he would find himself with 1,000,000 sovereigns in his pocket. A company with a capital of £1,000,000 is not in that position at all. The word capital in connection with companies has three meanings—first, nominal capital; secondly, issued capital; and, thirdly, paid-up capital. Now, if you register a company with a capital of £1,000,000, this £1,000,000 is nominal capital. What does it mean? Simply that the company is empowered, if it can, to issue shares to the extent of £1,000,000. If a capital is £1,000,000 in 100,000 shares of £10 each, this only means that if the company is able to induce persons to take up 100,000 shares

in it, it can give them the 100,000 shares. It means nothing else. Suppose, however, that the company, at a rather later stage of its career, is in a position to say that its issued capital is £1,000,000. That, again, does not mean that the company owns £1,000,000 in the sense in which a millionaire owns £1,000,000. A company with an issued capital of £1,000,000 in £10 shares is a company which has induced persons to take up 100,000 of its £10 shares. Its members are, among them, liable to contribute £1,000,000 to the company in the case of winding-up, provided, of course, that no calls have before that event been made upon the shares; for, you remember, that every call made and paid up on a share *pro tanto* reduces the liability in the winding-up. So a company with an issued capital of £1,000,000 is a company which is, or may be, entitled to call upon its members to pay up £1,000,000. Of course, if the people on whom the call of £1,000,000 can be made are not all in a solvent position, it may be that when the company proceeds to call for its £1,000,000 it will not get it. It follows that a company with an issued capital of £1,000,000 is very far from being necessarily a wealthy company. But a company with a paid-up capital of £1,000,000 is in a different position. The company has gone through a further stage. It first had a nominal capital of £1,000,000. It then induced people to take its shares, and it became a company with an issued capital of £1,000,000. It then went a step further, and called upon its members to pay up the amount of their shares, and thus gathered in £1,000,000. Hence, a company with a paid-up capital of £1,000,000 is a company which at some time or another has had 1,000,000 sovereigns in its coffers, or ought to have had 1,000,000 sovereigns in its coffers. I will explain in a moment why I put in the qualifying words "ought to have had." In any case, a company with a paid-up capital of £1,000,000 is not in such a satisfactory position as the individual with a capital of £1,000,000; for, although the £1,000,000 may have been in the coffers of the company, it may have got out again and been lost, but the figure of paid-up capital need not necessarily have been diminished. Then let me tell you the reason why, a few moments ago, I said that a company with a paid-up capital of £1,000,000 might perhaps be a company which had not had, but ought to have had, £1,000,000 in its coffers. We shall find later on that, subject to certain provisions

of the Act of 1867, a member of a company can satisfy the liability on his shares, not only by paying up the amount in cash, but by transferring to the company property of the value of the cash which he is liable to pay; or rather, to put it more accurately, by transferring property which, as between himself and the company, is to be taken to be of the value of the cash which he is liable to pay. If the member who is paying up his shares, and the company as well, are of unimpeachable honesty, the property which is taken as between the member and the company to be worth the money, may perhaps be worth the money. But there are such persons as fraudulent promoters, whose estimate of the value of the property which they transfer to the company is not always quite the same as the estimate which independent valuers would put upon it. A member of a company can only pay up his shares otherwise than in cash by going through certain formalities, and by registering certain documents with the Registrar of joint-stock companies; but, provided he goes through the formalities properly, it may well be that he pays up his shares by transferring a property not really of the value at which it is put. So the fact is that a company with a paid-up capital of £1,000,000 may never have had £1,000,000 in its coffers, but it may only have had transferred to it properties which a somewhat sanguine-minded promoter considered to be worth £1,000,000; and experience teaches that when dealing with millions the estimates of promoters are exceedingly sanguine.

In connection with this subject, I must explain to you a term you will not find in the Act at all, but you will often hear of in connection with companies, and that is the term "under-writing." You may imagine that a company attaches very great importance to the process of turning its nominal capital into issued capital. For this purpose it is necessary to get persons to take up its shares. The under-writer of shares is a person who agrees with a company, that if the public does not take up a given number of shares, he will take them up himself. He, in effect, guarantees that the public will apply for a particular amount of shares. Under-writing has to be remunerated. If the shares are good the under-writer's risk is very small and his remuneration will probably be small also. If the shares are bad the chances are that the public will not take up the shares (though this does not always

follow): but under such circumstances the risk is great and the remuneration which the under-writer will expect will probably be great also.

I must now say a few words on the question of the transferability of shares, and I will read you part of Section 22 of the Act of 1862. That Section runs as follows:

> "The shares or other interest of any member in a "company under this Act shall be personal estate, "capable of being transferred in manner provided "by the regulations of the company."

You will remember that in the last lecture I told you that one of the incidents of an ordinary partnership, is, that in the absence of special provisions in the partnership deed, new members cannot be admitted. The effect of this Section is that the shares of a company under these Acts are freely transferable but subject always to the provisions of the articles. Hence the company can provide by its articles that the shares shall be transferred with absolute freedom, without any restrictions at all; or it can provide by its articles that shares shall only be transferable under stringent conditions and stringent restrictions. Now-a-days there are a large number of companies, usually called private companies, chiefly companies which have been formed out of business concerns belonging to a small circle of persons, or a small number of partners, perhaps members of one family. In such private companies it is very usual to provide that shares shall not be transferred to anyone who is not a member of the company until they have been offered to other members, or to the chairman of the company, or to the directors, at a valuation. The effect of the Section, which I have just referred you to, is that provisions of that kind can be inserted freely in the articles. You can make your shares as freely transferable as you wish; or you can tie them up, and make the qualifications for membership as rigid as you please.

In dealing with capital, I omitted to mention subdivision and consolidation of shares. By Section 12 of the Act of 1862, which we need not stop to read now, it is provided that a company may so far modify its Memorandum of Association as to increase its capital and consolidate its shares into shares of a larger amount; and, under the Act of 1867, it is possible, under certain restrictions, to sub-divide the

shares. This is a matter really of the internal management of a company, and, as our time is restricted, I will not now go into it. But I must take the opportunity of explaining to you what stock is. You will find in many modern companies that the capital takes the form not of shares but of stock. Stock is, in effect, simply another name for fully paid shares. If the shares of a company are fully paid, they can be converted into stock by a resolution of the company. The effect of the alteration is that the shares, if I may so express it, lose their individuality and are fused into one undistinguished mass of stock. In dealing with stock on the Stock Exchange, it is transferred in sums of money, while, if the capital is in shares, the transfer is a transfer of so many shares. For example, if you have ten £10 shares you would sell the shares by number; you would sell two or five or ten shares. But, if your shares have been consolidated into stock the ten £10 shares will be represented by £100 stock; this can be transferred in any multiples you please, subject, of course, to any rule of the company as to the minimum amount transferable. Thus, you might transfer £7 or £58 of it, or in fact any amount. I must ask you not to confuse this kind of stock with debenture stock, which is a very different thing. Debenture stock arises, in effect, from the consolidation of a number of debentures, which are a particular class of debts; but stock, in the sense in which we have been using the term, arises from the consolidation of shares.

In connection with the subject of capital, I must also mention share warrants. Shares in a company are, as we shall find, always registered, and the names of the members of the company appear, or should appear, on the register in respect to the shares which they hold. It is found very convenient to be able to pass shares from hand to hand without going through the formalities of a transfer. By passing proper resolutions (under certain Sections in the Act of 1867, to which I need not refer in detail), a company can issue share warrants for its shares. The bearer of a share warrant is treated as the holder of the share mentioned in the warrant, notwithstanding that he is not registered as a shareholder. These share warrants are much in favour on the continent, but they have been comparatively little used in England, owing, to a great extent, to the heavy stamp duty payable on them. But I must mention them, because there

are a considerable number of companies in which they are used, mainly companies concerned with South African speculations which have been floated or bolstered up by French capital. French investors are familiar with and fond of shares to bearer; but the ordinary English investor does not much care for them.

I must now ask you to turn to a more important topic, and that is the topic of members. Section 23 of the Act defines what a member is, and it defines it in a very curious way. Section 23 is as follows:

> "The subscribers of the Memorandum of Association
> " of any company under this Act shall be deemed
> " to have agreed to become members of the
> " company whose memorandum they have sub-
> " scribed, and upon the registration of the company
> " shall be entered as members on the register of
> " members hereinafter mentioned; and every
> " other person who has agreed to become a
> " member of a company under this Act, and whose
> " name is entered on the register of members, shall
> " be deemed to be a member of the company."

The marginal note to this section is "Definition of member"; but it certainly is a remarkably unsatisfactory definition. However, the substance of it, as interpreted by the decisions of the Courts, is this: first of all, every person whose name has been entered on the register of members is *prima facie* a member of the company, and when a man's name has once got on to the register, he must show some good reason for getting free of the liabilities of a member; secondly, a person who has agreed to become a member may so far as liability is concerned, be treated, in effect, as if he were a member, though his name may not appear on the register. You will not find it easy to understand how this latter result is reached. It depends upon the principles of equity, I mean of equity in the technical sense with which we are familiar in Chancery. The subject is a difficult one, but I must attempt to explain it. It is a principle of equity that in equity that is deemed to have been done which ought to have been done. A court of equity, as you may perhaps know, is historically the Court of the Lord Chancellor. It was the practice of the Lord Chancellors to administer what was

called equity, and one of the principles which they applied was that which I have just enumerated. Let me give you a short example to show you what the effect of the application of this principle is. Suppose that A agrees to sell a piece of land to B, but that A does not carry out his contract. In an ordinary court of law, B could sue A, and get damages from him; but that, of course, might not be at all a satisfactory remedy. Suppose that B was very anxious to have the piece of land, because, for example, it was of importance to him as rounding-off his property. The damages he could get from the common law courts would be very inadequate compensation. B's remedy, in such a case, was to go into a court of equity. The Lord Chancellor would force A to do that, which, according to his conscientious obligations, as interpreted by the rules of the Lord Chancellor's Court, he ought to have done. The court of equity applied the maxim that that was deemed to have been done which ought to have been done; and the Lord Chancellor would deem that A had effectually sold the land to B, and proceed to force A to act accordingly. What in practice would happen would be that the Chancellor would order A to convey the land to B; and A would usually proceed to do so; for if he did not he would find himself committed to prison. On the same principles, if a man agrees to be a member of a company, but his name is not put on the register, though the circumstances are such that it ought to have been put there, the Court, acting as a court of equity, will treat him as if he were on the register, and will either direct the company to put his name there, or will treat him as being under precisely the same liability as if his name had been on the register. You see, then, that there are two classes of persons that may turn out to be members; first of all, the person who is on the register and is almost necessarily a member, and, secondly, the person whose name is not on the register, though it ought to be there; the latter is treated just as if his name were on the register, at all events, for the purpose of enforcing liability against him. It is not worth while for us to consider, in detail, how the liability to be placed on the register can be enforced. There is a great deal of complex law bearing on the subject, which is not likely to be of much interest or importance to you.

In Sections 25, 26, 27, 32, 33, and 35, you will find provisions relating to the register. The effect of them is, to put the

matter very shortly, that every company must keep a register of members in which must be contained the names, addresses, and occupations of the members, and the dates on which each person became a member and ceased to be a member. If the register is not kept up to date, certain penalties are enforced against the company. The company has to make annual returns as to various matters, and to render annually a list of members. Provision is made for enabling the register to be inspected by members of the company and members of the public, and for enabling it to be closed for a certain period in each year, and a summary mode of procedure is provided for deciding who should and who should not be on the register.

You will readily understand that now-a-days, when the operations of British companies are not confined to the United Kingdom, and when large companies are operating all over the world, it is exceedingly inconvenient to have only a single register, and that register in England. Under an Act called "The Colonial Registers Act, 1883," it is now possible, by passing the proper resolutions, to have not only registers in England, but also subsidiary registers in the Colonies, so that Colonial shareholders can be registered on the Colonial register.

Section 30 of the Act is of very great importance to the officers of the company. It runs as follows:

> "No notice of any trust, expressed, implied, or con-
> "structive, shall be entered on the register or be
> "receivable by the Registrar, in the case of
> "companies under this Act and registered in
> "England or Ireland."

You are aware, no doubt, that a large amount of property in this country is held not by persons to whom it belongs beneficially, but by persons who are called trustees. The effect of this Section and the decisions upon it is, roughly speaking, that the company is entitled, as between itself and its members, to treat its members as being absolute owners of the shares which stand in their names. This is, from the point of view of officers of the company, a matter of very great importance. Suppose A B is a member of a company; and that he holds his shares not in his own beneficial right but as trustee of a marriage settlement. If it were not for some such provision as that which I have just mentioned the company would never be able to deal with A B at all. Before

passing any transfer they would be bound to ask A B who his beneficiaries were, and what powers he had to transfer the share, without the concurrence of the beneficiaries. The company, in short, would be bound to see that they were not party to any breach of trust on the part of A B. With such questions as these to consider, it would be a matter of difficulty and danger to have trustees as members. The effect of Section 30 is, that the company may treat its members as if they were absolutely entitled to the shares. But to this there are certain limitations, which do not appear on the face of the Act, but must be gathered from the various decisions of the court. You can treat your member as absolutely the owner of his share, as between the company and the member, in his capacity of member, but if you are going to deal with him in any other capacity than that of a member you must not treat him as the beneficial owner of the share if you are aware that he is a trustee. For instance, suppose that a member comes to the officers of a company and wishes to borrow money from the company, and offers his shares as security. If he is a mere trustee of the shares the security will be a bad one. This transaction between the company and the member is a transaction of the nature of borrowing and lending; it is not a transaction with the member, purely in his capacity as a member; it is an ordinary commercial transaction; and for the purposes of such a transaction the company cannot shut their eyes to his position as a trustee and treat him as the absolute owner.

Section 31 provides that a certificate, under the common seal of the company, specifying any share or stock held by any member of a company shall be *primâ facie* evidence of the title of the member to the share or stock therein specified. It is the practice of companies under this Act to issue certificates, stating that a particular member is the holder of shares with particular numbers and of particular amounts, with so much paid up on each of them. The importance of the certificates lies in this, that on the Stock Exchange the share certificate is treated by virtue of this Section as *primâ facie* evidence of title to the share: and for this reason officers of a company have to be exceedingly careful in preparing the certificates. The certificate is simply a statement under the seal of the company of certain facts, the facts being that A B is the holder of a particular share, and that that share is, say,

a £10 share, and that, say, £5 has been paid upon it. Let me give you an example of the very serious consequences that may ensue through any inaccuracy. Suppose that £5 only has been paid on a particular £10 share, but the company by some mistake issue a certificate stating that £10 is paid up on that share. The man who first receives the certificate probably knows the facts, and he knows that it is a mistake, and that only £5 has been paid. But suppose that he transfers his share to someone else who does not know the facts, and the company issues a new certificate to this other person, stating that £10 and not £5 is paid on the share. That other person is entitled as against the company to insist that £10, and not £5, has been paid. This arises from a legal principle, which I will not go into at great length, called the principle of estoppel. The principle is, shortly, that if a person has made a representation upon which he intends that someone else shall act, and the representation is acted upon accordingly, the person making the representation is for ever afterwards prevented, or "estopped", from denying that the representation was true. This will suggest to you the great importance of accuracy in certificates; for a mistake on the part of an officer in preparing a certificate may prevent a company from ever afterwards saying that the facts stated by mistake on the certificate are not the true facts, and the effect may be that shares will go out to the world as, and have to be treated as, fully-paid shares, although the company has never received the money for them.

The law relating to promoters and to prospectuses is of vital importance to persons concerned in the forming of companies, but for our purpose a few words on these topics will suffice. As you may well imagine, a company could scarcely exist without a promoter in some shape or form. There must be someone to get together the subscribers to the Memorandum of Association, to give directions for preparing the memorandum and articles, to see to the payment of the necessary fees, and, in fact, to set the thing going; and this person is called the promoter. It is unfortunate that the word promoter has rather fallen into disrepute. Many persons of the highest integrity find themselves occasionally in the position of promoters, and there is no reason why they should not discharge their duties with both honesty and success. But the promoter, after all, is the master of the

situation, and this is a position which is not always conducive to honesty. The promoter may form a company, and when he has formed it may be tempted to sell to it a bogus, or practically bogus, business at a large figure. This is commonly the history of a fraudulent promotion. But the sale is only the first step: the next is to issue a prospectus to the public, inviting the public to take up shares in the company.

A prospectus is a document which sets forth the merits of a concern, often in somewhat glowing terms, and offers to the persons to whom it is addressed an opportunity of taking shares in the concern. It is well to remember that the prospectus usually goes out to people who have, for all practical purposes, very little means of testing the fairness or the accuracy of the statements contained in it.

Against the promoter a company is protected by a rather curious legal theory. The theory is that the promoter who has brought the company into being is in the same relation to the company as a trustee is in to a beneficiary; or, to put it in technical legal language, the promoter is in a fiduciary relation towards the company. The main obligation that this fiduciary relationship involves, is that the promoter or the trustee, as the case may be, must not make a profit at the expense of the beneficiary or the company without disclosing the profit. You will find that, in connection with projects of company reform, the question which, in one shape or another, is continually cropping up, is, how to insure that the promoter shall make a full disclosure to the company of the profits of the promotion. The extent to which the promoter is bound to make disclosure, and the exact effect of not making the requisite disclosure, are questions involving a good deal of legal difficulty; and as your time is limited, and there are others subjects which are perhaps of more importance to you than the exact rights and liabilities of promoters, I do not propose to go into these questions at length. But I must draw your attention to Section 38 of the Companies Act of 1867. This section deals with prospectuses, and it is very important for all officers of companies to bear it in mind. The Section provides, in effect, that every prospectus of a company, and every notice inviting persons to subscribe for shares in a company, is to specify the dates and the names of the parties to any contract entered into by the company or

the promoters, directors, and trustees of the company before the issue of such prospectus or notice, whether subject to adoption by the directors or the company or otherwise; and any prospectus or notice not complying with the Section is to be deemed fraudulent as regards any person taking shares in the company on the faith of such prospectus, unless he shall have had notice of such contract. The aim of the Section is to ensure that the prospectus should give notice to the world what contracts the company has entered into; and the Section is, no doubt, particularly aimed at such contracts as those I have been describing, under which promoters bind companies to buy bogus businesses at an inflated figure. But the importance of the Section for your purposes is, that the Section applies not only to the first prospectus of a company, but to every prospectus that a company issues at any stage of its career. As a matter of fact, when a company which has been going on for some time issues a prospectus, the Section is unworkable. An ordinary trading company has dozens, perhaps even hundreds, of contracts pending at any particular moment; contracts, perhaps, for the sale and purchase of goods, or contracts for freight or carriage. It would be a physical impossibility to mention the dates and the names of the parties to such contracts in the prospectus. An attempt is often made to get over the difficulty by what is known as the "waiver clause." The "waiver clause" is a clause stating that any person applying for shares on the faith of the prospectus, is to be deemed to apply on the terms that he waives any rights he may have against the company or directors for not complying fully with Section 38 of the Act of 1867. A very serious question has been raised as to whether the waiver clause is of any validity. The suggestion is that the Act imposes certain obligations upon directors and promoters of companies, that it imposes a statutory duty towards the applicants for shares, and that it is not possible for a person to bind himself by agreement to waive the performance of a duty imposed by an Act of Parliament. Whether that view is correct or not has not yet been decided; but I must impress upon you that if it ever falls to your lot to be concerned with the preparation of a prospectus, you will be unwise if you assume that the waiver clause is necessarily valid. You should take the greatest care to specify, as far as you possibly can, the dates and

names of the parties to all contracts, otherwise you may place your directors under very serious liabilities.

There is one more point in connection with the formation of companies which I ought to mention. I must draw your attention to Section 4 of the Act of 1862. That section provides that (with the exception of companies incorporated by Special Act and certain other exceptions, to which I need not refer) no association or company of more than twenty persons is to be formed, after the commencement of the Act, for the purpose of carrying on any business which has for its object the acquisition of gain, unless the company is registered as a company under the Companies Acts. The effect of that is that, since 1862, it has been impossible, broadly speaking, to form any companies except under the Companies Acts. There are still in existence a certain number of companies formed before 1862, which are outside the Act. But the effect has naturally been that companies under the Companies Acts are now looked upon as the normal form of company, and there is a strong tendency amongst other companies to assimilate their constitution as far as possible to the constitution of ordinary companies under the Companies Acts. You will remember that I have already drawn your attention to the fact that companies formed before 1862 by a deed of settlement, can, when they have registered themselves under the Companies Acts, and have taken proper proceedings, get rid of their deed of settlement, and assimilate their constitution to that of an ordinary company with a Memorandum and Articles of Association. That is a step in the direction of simplification, of which a great deal of advantage has already been taken.

"THE COMPANIES ACTS."

THIRD LECTURE.

III.—Management and Administration of Companies.

In this and the next two lectures I shall draw your attention to certain points arising in the management and administration of companies, and I shall take as, so to speak, the text of my discourse Part III of the Act of 1862, and what is called Table A. I must begin by explaining what Table A is. If you look at the first schedule of the Act of 1862 you will there find Table A, which is a specimen form of Articles of Association. Sections 14 and 15 of the Act of 1862 provide, to put the matter shortly, that in the case of any registered company you must, in the ordinary way, register Articles of Association; but that, in the case of a company limited by shares, you may register the Memorandum without any Articles, the effect being that Table A will apply to, and will be the Articles of Association of, the company. Table A is of considerable interest, because the vast majority of modern companies have framed their Articles on its model. Indeed the chief provisions of Table A are, in all essentials, to be found in almost all Articles of Association; so that, in considering the various points with which we are about to deal, you may treat Table A as containing such provisions as you may reasonably expect to find reproduced in the Articles of any company with which you may be concerned.

The first point to consider is how far the Articles can be altered. When I speak of Articles, I include Table A, for if a company is formed with Table A as its Articles, it can alter

Table A so far as its own proceedings are concerned, to the same extent as any other company can alter its Articles. Sections 50 and 51 of the Act of 1862 deal with alterations in Articles of Association. The effect of these Sections is that any of the regulations of the company contained in the Articles of Association can be altered by a special resolution. Now a special resolution is a resolution which has been submitted to two meetings of the company. The two meetings must be held at an interval of not less than 14 days and not more than a month. In order that the resolution may be a special resolution a proper notice of it must be given, and the resolution has to be passed at the first meeting by a three-fourths majority, and it has to be confirmed at a second meeting by a bare majority. A resolution so passed is a special resolution, and may operate to alter the Articles of Association. The words of Section 50, dealing with this matter, are very wide. The Section provides, that subject to the provisions of the Act and to the conditions contained in the Memorandum of Association, any company may, by special resolution, alter any of the regulations contained in the Articles of Association. At first sight it would seem that the Section authorises any alteration of the Articles. But at present it has not yet been clearly decided whether or not that is the effect of the Section, and indeed there is some ground for supposing that that is not its effect. Let me give you an example. Suppose that a company has a capital of £100,000 in ordinary shares, and that the company wishes for more capital, and proceeds to attract capital by offering to the persons who are willing to take shares a preference over the holders of the other shares. We shall have to deal later in more detail with preference shares; for the moment, it is enough to say that a preference share is a share which gives its holder some greater right than the ordinary shareholders have. That greater right usually takes this form, that the preference shareholder is entitled to take his dividend out of the funds of the company before the ordinary shareholder gets anything. Coming back to our example, let us suppose that this company has issued to the new shareholders 20,000 preference shares, giving the new shareholders preferential rights, and has embodied these preferential rights in its Articles by inserting an article providing that the holders of preference shares shall have the preferential rights in question.

Can this article be altered? Suppose that the voting in the company is so arranged that every member has one vote for every £1 of share capital. A simple calculation will show you that the ordinary shareholders will have 100,000 votes while the preference shareholders, if there are £20,000 worth of preference shares, would, on the hypothesis I have stated, have 20,000 votes. From that, it follows, that the ordinary shareholders could, by a special resolution, which requires three-fourths majority, decide in the teeth of the preference shareholders, to alter the Articles of Association. Could they alter the article relating to the preferential rights and provide that thenceforward the preference shareholders should not have the preference originally given them? This, you notice, would be an alteration of the Articles; but possibly the right view is that it would be something more than that; it may be that it would be an alteration, not only of the Articles, but of the rights vested in the preference shareholders by the contract under which the shares were issued to them, and it is a serious question whether Section 50, which authorises, no doubt, alterations of Articles, authorises a process such as this, which is not merely an alteration of the Articles, but an alteration of existing rights. The question is a difficult one, and at present it would be rash to say what the right answer to the question is. But what I want to impress upon you is this, that you will not be safe in assuming, notwithstanding the very wide words in Section 50, that by a special resolution you can take away the existing right of shareholders, although it is true, generally speaking, that by special resolution you may make any alteration you please in the Articles of Association.

You see then, that, subject to the question I have mentioned, the Articles of Association of a company can be altered by taking the proper steps. But they can be altered, of course, only subject to anything contained in the Act; and so, before considering any points as to the administration and management of companies, which would ordinarily be dealt with under the Articles of Association, we ought to look at the Act and see if there are any provisions in the Act which govern the administration and management of companies. Now, there are such provisions, and I propose to go through them shortly.

In the first place, every company must have a registered

office; that is provided for by Section 39 of the Act of 1862. By Section 40, notice of the situation of the registered office must be given to the Registrar of Joint Stock Companies; and by Section 62, notices can be served on the company at its registered office. The registered office is the company's home, and so it is natural that some notification of this fact should have to be given to the outside world. You will find that under Sections 41 and 42 of the Act of 1862, it is provided in effect that every limited company must put up its name outside its office; and Section 42 also provides that the name of the company must be placed on every bill of exchange, promissory note, cheque or order which the directors may send out. The object of this is, of course, to ensure that the fact that the company is incorporated, and incorporated with limited liability, should as far as possible be brought home to every person dealing with the company. That provision is of the very greatest importance to the officers of a company, for this reason, that the same Section provides that if a director, manager, or officer of a limited company issues any notice or signs any bill on behalf of such company on which the company's name does not appear, he is to be liable to a penalty and also personally liable on the bill.

In connection with these provisions as to the use of a limited company's name (which includes, as the last word in it, the word "limited"), I must draw your attention to Section 23 of the Act of 1867, which under certain circumstances enables a limited company to dispense with the use of the word limited. This can only be done by leave of the Board of Trade, and only in the case of companies formed for purposes not involving pecuniary gain. A certain number of companies (as for example, the Institute of Mechanical Engineers) have been formed as limited companies under the Act and have taken advantage of this Section, and so are dispensed from adding the word limited to their names. In the case of institutions of this kind, there is no danger to the public in the absence of the word limited from their names, as such institutions are not likely to have liabilities of any moment. I should also mention, in connection with the subject of the name of the company, that under Section 13 of the Act of 1862, a company can alter its name by taking the proper proceedings and obtaining the approval of the Board of Trade.

The Acts contain various provisions for making periodical

statements and returns to the Registrar of Joint Stock Companies and for keeping certain registers. It may be convenient that I should give you a list of the various provisions in the Acts in regard to these matters, for they are matters which officers of companies have to attend to very carefully. We will first deal with the registers. A company under the Companies Acts must, under Section 25 of the Act of 1862, keep a register of shares, or rather a register of members which, in the case of a company limited by shares, is practically the same thing as a register of shares. I have already spoken of the register of members, and I need only remind you that it must show the names, addresses, and descriptions of the members, a statement of their shares, distinguishing each share by number, a statement of the amount paid up on each share, the date at which the member became a member, and the date at which any person ceased to be a member. If shares are converted into stock, certain necessary modifications have to be made in the register, and this is provided for by Section 29 of the Act of 1862. So, also, if share warrants to bearer are issued, the register will again have to be modified, and this is provided for by Section 31 of the Act of 1867. The Act of 1862 further provides (Sections 32 and 33) that the register of members must be open all the year round, save that it may be closed for not more than thirty days in the year, if the closing is advertised. It must be open at least two hours a day. Any member can see it *gratis*, but anyone else has a right to see it on payment of a fee not exceeding one shilling. Section 37 provides that the register is to be *prima facie* evidence of everything properly contained in it. Then, under Section 43 of the Act, a limited company has to keep another register, a register of all mortgages and charges specifically affecting the company's property. This is open to the inspection of any creditor or member of the company, but curiously enough no one else, not even if he is proposing to become a creditor of the company, is entitled to see it. There is a curious point about the register of mortgages which at one time caused a good deal of difficulty. For a long time it was supposed that no mortgage by a limited company in favour of a director or any other person whose duty it was to see to the keeping of the register of mortgages could be treated as valid until it had been registered. That, however, now proves not to be a correct view. It is now

settled that the only effect of not registering a mortgage is that any director or officer of the company who knowingly permits the non-registration lays himself open to penalties. There is another register which I must mention for the sake of completeness, though it does not really concern us much. Section 45 of the Act of 1862 provides in effect that companies limited by guarantee must keep a register of their directors and managers.

So much for the registers which companies have to keep. I will now state shortly what are the statements, returns, and notices that have to be sent in to the Registrar of Joint Stock Companies. In the first place, you will remember that on the formation of a company the Memorandum and Articles have to be registered, and I ought to tell you that by Section 19 of the Act, any member of the company who wishes for a copy of the Memorandum and Articles of Association is entitled to have it on paying a shilling. Then you will remember that under Section 40 the company has to give the Registrar notice of the situation of its registered office, and of any change in the address of its registered office. Under Section 26 the company must once a year send in to the Registrar a list of its members, the list being made up as on the fourteenth day after the first ordinary general meeting of the year. The list is to contain what is in effect a summary of the particulars contained in the register of members. The list and summary is to appear in the register, and is to be sent in to the Registrar of Joint Stock Companies within seven days after the fourteenth day after the first ordinary general meeting. If you will look at the second schedule of the Act of 1862 you will find a form called Form E, which shows exactly what the summary is to contain. Then there are certain special returns provided for by Section 44 of the Act of 1862, which have to be made by limited banking companies, and by all insurance companies. Such companies must, before commencing business, and also in February and August of each year, make out a statement in the Form D, which you will find at the end of the first schedule of the Act of 1862, showing the company's capital, its assets, and its liabilities. A copy has also to be put up in the company's head and branch offices, and every member and creditor, if he wants it, can obtain a copy for 6*d.* These are the regular periodical returns: but, besides these returns, I must remind you that,

under Section 53 of the Act of 1862, the company must send in to the Registrar of Joint Stock Companies, a copy of every special resolution passed by the company, and under Section 54 every special resolution passed by a company must be attached to the prints of its Memorandum and Articles of Association; and no copy of the Articles must be sent out without having a copy of every special resolution for the time being in force annexed to it. Then the company also has to give notice to the Registrar under Section 28 of any consolidation of shares, or of the conversion of shares into stock, and under Section 34 it has to give notice of any increase of capital, or, in the case of a company limited by guarantee, of any increase in the maximum number of its members.

So far, I have been dealing with statements and returns which have to be made under the Companies Acts; but I must supplement this by showing you what statements and returns have to be made under the Life Assurance Companies Acts of 1870 and 1872. Life Assurance companies must, if they are life assurance companies and nothing more, make returns of their revenue, accounts, and balance sheets in the forms in the first and second schedules of the Act of 1870. If they transact not only life business but other classes of insurance business, the returns are to be in the more elaborate forms which you will find in Schedules 3 and 4 of the Life Assurance Companies Act of 1870. These forms must be sent in to the Board of Trade. The Life Assurance Companies Act of 1870 also provides for a periodical investigation of the financial condition of every life assurance company, and for the furnishing of an abstract of the actuarial report made on such investigation, and of a statement of its life assurance and annuity business made up as at the date of the investigation. The financial investigation must be made in the case of companies formed before the passing of the Act every ten years at least, and in the case of other companies every five years at least, and a statement of the results must be drawn up within nine months after the date as on which the investigation was made.

In connection with the subject of returns to the Board of Trade, it is interesting to notice that the scheme of the Act is that the Board of Trade should have a sort of general supervision over companies; and by Section 56 of the Act of 1862 it is provided that, upon the application of a certain proportion of members, the Board of Trade can appoint

inspectors to examine into the affairs of the company, and report thereon. That power is not very often put into force, but it has just lately been used in a case which has gained some public notoriety, and in that case it was, I believe, exceedingly effective.

I propose now to go to Table A, and to deal with the various topics which are dealt with in Table A, but for the moment I shall not take them in quite the same order. I shall begin with the subject of meetings, a subject to which officers of companies ought to pay great attention. The Act of 1862 provides, in Section 49, that a general meeting of every company must be held once at least in every year, and the Act of 1867, Section 39, provides that a meeting is to be held within four months after the incorporation of the company. The object of these enactments is, of course, to ensure that the members shall be in a position to exercise a certain amount of control over their directors. A general meeting is the organ through which the members of a company make their wishes felt. You will remember that by a special resolution of a general meeting articles can be altered. An ordinary resolution, by which I mean a resolution only passed at one meeting, and there passed only by a bare majority, does not operate to alter a company's constitution; but it is the appropriate way in which a company expresses its will. If in the Articles of Association it is provided that the company may do any act, as, for example, that it may authorise the directors to borrow up to a certain figure, the company can give expression to its wish, and do the act through the medium of a resolution at a general meeting. The first question in dealing with meetings is, what notice must be given before the meeting is held? The length of notice is usually prescribed by the articles. You will find a specimen article in Article 35 of Table A, which is reproduced in much the same form in the articles of most companies under the Acts. This article provides that seven days' notice at least, specifying the place, day, and hour of meeting, and, in case of special business, the general nature of such business, shall be given to the members in such manner as may be prescribed by the company in general meeting. To find out what special business means in this article, you must look at Article 36, which runs as follows: "All business shall be deemed special "that is transacted at extraordinary meeting, and all that is

" transacted at ordinary meeting, with the exception of " sanctioning a dividend and the consideration of accounts, " balance sheets, and ordinary report of the directors." You will find that in Table A, and in articles following the form of Table A, an ordinary meeting means, in effect, the annual meeting which the Act prescribes, and an extraordinary meeting means any other meeting. The effect is, substantially, that notice must be given in the notice of meeting of the business which it is proposed to transact at the meeting, unless the business is merely what is ordinarily called routine business, *i.e.*, the declaration of dividends and consideration of the accounts and balance sheets and the ordinary report of the directors. But let me warn you that my remarks apply solely to articles in the same form as Table A. Let me warn you that if you want to find out what notice has to be given of any meeting of a company you must not turn to a text-book and see what the text-book says under the head of meetings. You must first go to the articles of your company, and see what they say; for it is the articles you have to follow, provided, of course, that the articles are consistent with the Act. We ought, then, to consider whether, in connection with notices of meetings, there is anything in the Act with which the articles of association may be inconsistent. If you propose at a meeting to pass a resolution which is to operate as a special resolution, you must take care that your notices conform to Section 51 of the Act. This Section defines a special resolution as being a resolution which, amongst other things, is "passed " at a meeting of which notice specifying the intention to " propose such resolution has been duly given." So you must remember that, whatever your articles say, even although your articles say that no notice of meeting is necessary under any circumstances, nevertheless, if you propose to hold a meeting at which a special resolution is to be passed, you must take care that your notice of meeting conforms with Section 51, and that it specifies the intention to propose the resolution. There is another point in connection with special resolutions which I must impress upon you, and that is that you must take care that between the first and second meeting there is a proper interval, not less than 14 days, or more than a month; and you must also take care that your notice of the second meeting is not what is called a mere contingent notice. At one time, when people were not so familiar with these Acts as

they are now, it was thought that one notice of both meetings was sufficient. Sometimes notice was given that a meeting would be held to consider and pass a special resolution, and if passed, then a second meeting would be held a fortnight afterwards to confirm the resolution. It has been held that such a notice, standing alone, is no good. It will not do to give notice that the second meeting will be held if the resolution is passed at the first meeting. The right way is to hold the first meeting, and then, when the first meeting has been held and the resolution has been passed, to send out a second notice calling a second meeting for the purpose of confirming the resolution. The effect of not having a proper interval and a proper notice will be that the resolution will not be validly passed: it will be a nullity; and if it purports to alter the articles of the company, it will be ineffective, for the articles will remain unaltered. Let me give you one practical rule as regards notices, and that is to insert in the notice, if possible, the exact resolution which is to be proposed at the meeting. But suppose that when you look at the articles of your company you find that there is no provision as to summoning meetings at all, what is to be done? The answer will be found in Section 52 of the Act of 1862. That Section is as follows: "In default of any regulation as to voting, every "member shall have one vote, and in default of any regulation "as to summoning general meetings, a meeting shall be held "to be duly summoned of which seven days' notice in writing "has been served on every member in manner in which "notices are required to be served by the Table marked A in "the first schedule, and in default of any regulations as to "the persons to summon meetings, five members shall be "competent to summon the same, and in default of any "regulations as to who is to be chairman of such meeting, it "shall be competent for any person elected by the members "present to preside." The importance of that Section is that it has been held to apply not only where there is no provision in the articles as to these various matters, but also where, although there is a provision in the articles, the provision is for any reason inoperative. For example, suppose that the articles provide that the directors are to summon the meetings, but in consequence of death or disqualification there are no directors left, you can have recourse to this Section, and the meeting can be summoned by five members. You will

probably suppose that a total failure of directors is a rare thing, but it is by no means impossible in a small company.

Now suppose that we have got so far as to have summoned our meeting properly, the next question that will have to be considered will be, when is the meeting properly constituted, or in other words, when is a quorum present? You will usually find that the articles provide that a particular number of persons shall form a quorum, and that if a quorum is not present at a particular time the meeting is to be adjourned. The first point, therefore, you have to consider is, whether there is a quorum present, and as soon as the quorum is present the next question is, who is to take the chair? Now that again you will usually find provided for in your articles; but if, by some oversight, your articles do not provide who is to take the chair, you must have recourse to Section 52, under which, in default of any regulations as to who is to be chairman, any person elected by the members present may preside. When the chairman has taken the chair, the next business will usually be to read and confirm the minutes of the previous meeting. I shall have to say a few words later on as to the minutes, so I will pass them by for the moment. Probably the first question upon which the chairman of the meeting will want advice from the officials of the company will be that of voting. Under the usual forms of articles, resolutions put to meetings are, in the first instance, voted upon by show of hands, and it is only after a vote by show of hands that a poll can be demanded. It is usually provided that on a show of hands each member present has one vote, but it is also usually provided that on a poll members have votes varying in number, according to their holding in the company. As you may well imagine, the effect of such provision usually is, that voting by a show of hands is, to a great extent, an empty form; if there is to be any opposition to a resolution, nobody will be content to abide by a vote on a show of hands, but a poll will at once be demanded, for a poll overrides the show of hands. The question then arises, who can demand a poll? That is a point which always ought to be dealt with in the articles, and usually is. It is usually provided that a small number of persons, perhaps three or four, can demand a poll. It is usually provided that if a poll is demanded, it can either be taken at once or after an adjournment, and the choice is usually left to the decision of

the chairman. It is almost always provided, that on a poll votes can be given by proxy. In order to discover what number of votes each member can give on a poll, you must look at your articles. In the articles of modern companies it will usually be found that each member has one vote for each share, and that is, of course, simple and convenient. In some old-fashioned companies, it is provided, as it is in Table A, that the number of votes shall vary according to a scale. Article 44, of Table A, gives each member one vote for every share up to 10, a further vote for every five shares from 10 to 100, and a further vote for every 10 shares beyond 100. The object of an article, in this form, is to protect the small shareholder, and to give him a larger voting power in proportion than the large shareholder. However, the matter is not really of much importance, for there is nothing to prevent a large shareholder from breaking up his holding and transferring his shares into the names of nominees, in order to give himself, through them, a larger voting power.

I must now say a few words on the subject of proxies. You will find in Article 51, of Table A, what is practically a common form of proxy paper. A proxy paper is simply a paper signed by a member by which he appoints some other person, usually a member of the company, to vote for him and on his behalf at a particular general meeting of the company. There are several points to remember with regard to proxies, and I am going into these points in some detail, because they have generally to be dealt with by the permanent officers of the company, before the meeting, since the chairman of a meeting has usually no time to deal with them. In the first place, you must look in the articles of the company to see whether your proxy papers have to be witnessed. Old-fashioned articles often provide that proxy papers have to be witnessed, and when shareholders send in their proxies they have a very inconvenient habit of overlooking the directions provided for their guidance. If the articles provide that the proxy paper shall be witnessed, any proxy paper not witnessed is ineffectual and must be rejected. It is also very commonly provided that no person can be appointed a proxy unless he is a member of the company. The reason usually given for this is, that directors of companies have a dislike to members sending their legal advisers to meetings. I am told that directors consider that the presence of lawyers

at meetings does not always conduce to harmony. It is, however, not very difficult to evade such a provision. If a member wishes to send his solicitor to a meeting, all he has to do is to transfer one of his shares into the solicitor's name. The solicitor, thereupon, becomes a member of the company, and can attend the meeting in his own right, and also act as his client's proxy. It is not within the power of a company, in the absence of a special provision in the Memorandum of Association, to spend its funds in sending out stamped proxy papers. The reason is that the proxy paper is, in theory, sent out merely for the convenience of the members, and, *prima facie*, each member ought to pay for his own convenience. I mention this as a warning, but as a matter of fact, I believe that directors often do send out stamped proxies at the cost of the company, trusting that nobody will ever raise any objection to it. The stamp is only a penny stamp, but in a large company even a penny stamp on each proxy runs up to a considerable figure. It is also improper for directors to send out at the expense of the company proxy papers with the name of the proxy printed on them. This is very commonly done. Directors often send out proxy papers with their own names printed on them, and request the shareholders to sign the papers. The effect of this is to give the directors the control of the votes, and it has been held to be improper for directors to attempt to control the shareholders' votes, the reason being that they ought not to use their position as directors to control the votes of the persons in whose service they are. It is usually provided that proxy papers are to be deposited at the office of the company some short time before the meeting, the object being to give the officers of the company time to look through the proxy papers, and see whether, having regard to the various points such as I have mentioned, the proxy papers are valid.

The actual business at meetings of companies is always transacted in the form of resolutions. It is the chairman's duty to put the resolutions to the meeting, and it is for the chairman to decide questions of order, and generally to act as the mouthpiece and leader of the meeting. The articles generally give the chairman ample powers of control; for example, power to adjourn the meeting with its consent; and the articles usually contain some provision making the chairman's declaration that a resolution has been carried or lost

prima facie evidence of the fact. As regards special resolutions, Section 51 of the Act of 1862 provides that the declaration of the chairman that a special resolution has been carried shall be conclusive evidence of the fact; this is exceedingly convenient, as it avoids any danger of any one questioning the validity of the resolution on the ground of trifling irregularities; but I must warn you that the Section in no way absolves the officers of the company from the duty of seeing that all proper notices are given, and that all the proceedings are regular, and in strict accordance with the Act and with the articles of the company.

It is the duty of the company to have proper minutes kept of the proceedings at meetings. This is provided for by Section 67 of the Act of 1862. Shortly, the effect of this Section is that minutes must be kept of any meeting of the company or of the directors, and that until the contrary is proved every meeting, minutes of which have been made and signed by the chairman of that or of the next meeting, in accordance with this Section, is to be deemed to have been duly held and convened, and all resolutions passed thereat are to be deemed to have been duly passed. In other words, the minutes, if properly kept and signed by the chairman of the meeting or the chairman of the next subsequent meeting, are for all practical purposes to be treated as conclusive evidence that the meeting was held properly, and that the proceedings were regular.

You will remember that I told you that a general meeting is the organ by which the company expresses its views; but you will notice that Articles usually provide that meetings shall be summoned by directors. The usual object of a meeting is to exercise some control over the directors, and you will naturally want to know what means there is by which a member of a company can insist upon having a meeting summoned as a check upon the directors. You will usually find, in the articles, provisions to the effect that a certain proportion of members can send in a requisition to the directors, requiring them to convene a meeting, and that if the directors do not convene a meeting when required to do so, the requisitionists may themselves convene a meeting. You will remember that the register of members shows who are the members of the company and what their addresses are, and any member can have access to the register and can take

copies of it; so that if members wish to summon a meeting and the directors are obstructive, the members can insist on seeing the register of members, can take a copy of the names and addresses of the members, and can, after making the proper requisition, send out to the members the necessary notice convening a meeting. Therefore, if the articles of a company comprise the usual requisition clauses, it is impossible for the directors to muzzle the company.

This brings us to the difficult subject of the rights and remedies of a minority of members, and I will only lay down one or two general propositions by way of showing you the principles on which those rights and remedies depend. The ruling principle is that the Law Courts will not interfere with the internal management of a company. The scheme of the Acts is that a man goes and must go into a company on the footing that he and others who think like him, if they happen to be in a minority, must yield to the majority. The Court will not usually help him if he is in a minority, although he may think the majority are not acting properly in the company's interests. But to this principle must be added another, that the Court can and will interfere to prevent a company, or the directors on behalf of the company, doing anything which is outside the powers of the company, or which is an interference with the individual rights of a member. For instance, suppose, to take an extreme case, that the directors were to refuse to allow a particular member to vote at a meeting of the company; although the company in general meeting might pass a resolution sanctioning the action of the directors in preventing the member from voting, still the Court would interfere to protect him, because the action of the company and of the directors would be an interference with the man's individual right. In the same way, if the majority of the directors quarrelled with a director and attempted to exclude him from the directors' meetings: although the excluded director might be in a minority, the Court would interfere on his behalf, because there would be an interference with his individual right to act as a director and his legal duty so to act. So that the matter may be put with sufficient accuracy for our present purposes thus :—So long as nothing is done which is outside the powers of the company, or which infringes the legal rights of an individual, the minority is entirely in the hands of the majority. Probably, if the general public realized this more, they would

be less ready to go into companies, and probably there would be fewer cases of fraud. When a man goes into a company he is bound to give up to a great extent his rights as an individual. When he finds out that he has deprived himself of the right of insisting upon his own views against those of a majority, he is often only too ready to complain that he is harshly treated and to bandy about charges of fraud. The real answer to him is that he ought to have had his eyes open, and that, if he goes into an adventure in co-operation with other persons, he must make up his mind to bow to the decisions of his co-adventurers, however unsatisfactory he may consider them to be.

"THE COMPANIES ACTS."

FOURTH LECTURE.

IV.—Management and Administration of Companies (*continued*).

We have now to deal with certain matters relating to shares, and these matters will be suggested by the provisions in Articles 1 to 7 and 12 to 22 of Table A. You will remember that the Memorandum of Association of a company has to be signed by seven persons and that those seven persons by so signing become members of the company and become bound to take the shares which are described opposite to their names in the memorandum. As a matter of practice and convenience it is not usual for the memorandum to be signed by more than seven persons, but, as a matter of law, there is no reason why any number of persons should not sign the memorandum. But I want you to consider how persons can become members of a company otherwise than by signing the memorandum. I am not speaking, for the moment, of persons who have had transferred to them shares formerly held by other members of a company, but of persons who become members in respect of new shares. What practically happens is, that the intending member signs what is called a form of application. The form of application is simply a letter addressed to the directors, requesting them to allot to the applicant a certain number of shares. You are probably familiar with the ordinary form of application which almost invariably accompanies prospectuses. The application form, when it has been signed, is sent to the

directors, accompanied, as a rule, by a cheque for a deposit as a kind of guarantee of good faith. It is then for the directors to decide whether they will allot any, and, if any, how many, shares to the applicant. When they have made up their minds on this subject, they will pass a resolution that so many shares be allotted to the applicant, and will then send the applicant notice that they have allotted to him so many shares. Let us pause there and see what the legal effect is. The applicant has offered to take a certain number of shares, and the company has accepted his offer. This makes a binding contract as between the applicant and the company, and from that moment the applicant is bound to take the shares, and the directors may at once, and should as soon as possible, put the applicant's name on the register. From that moment the shares are issued, and the applicant is a full member. Suppose that the share for which the applicant has applied is a £10 share, and on his application, by way of deposit, he has sent ten shillings as a deposit in respect of the share. When he is put on the register he is the holder of a £10 share, with £9. 10*s*. still to be paid upon it. But it sometimes happens that shares are issued in the first instance as fully paid, and there are two ways in which this may happen. The applicant may perhaps send in, either with his application, or (as is more often the case) in various instalments, at various dates, before the share is issued, a sum equal to the whole of the nominal amount of the share. If he does that, when the share is issued to him, he will be the holder of a share with the whole of the nominal amount of it paid up. But there is another way in which a share can be issued as fully paid. A man may sell to the company property for a sum of—let us say—£100,000, and may contemporaneously agree with the company that instead of the company paying him £100,000 in cash, they shall satisfy the purchase-money of £100,000 by issuing to him shares of the nominal amount of £100,000, with the whole of that amount credited as paid up. You will notice that this arrangement is not altogether a satisfactory arrangement for the public. Although the vendor may have agreed to sell his property to the company for the £100,000, it may well be that the property is not worth that figure. There is, however, one safeguard, and I have already mentioned to you what it is. You will remember that I have already told you that, under Section 25 of the Act of 1867, before a

company can issue fully paid up shares against a payment not in cash but in property, it is necessary that the company should enter into an agreement to the effect that payment should be made in property and not in cash, and further, it is necessary that before the issue of the shares the agreement shall be filed with the Registrar of Joint Stock Companies. You will notice what the effect of this is. Every fully paid share must, as I have told you, have been paid for either in cash or in property. If it has been paid for in property, you can go to the office of the Registrar of Joint Stock Companies, and you will there find the contract which provided for the payment of the shares in property, and in the contract you should find a description of the property against which the share was issued as fully paid. By an Act passed in 1898, provision has been made for dispensing shareholders from the consequences which occasionally ensue from errors in regard to the filing of such contracts as I have mentioned. It occasionally happens, sometimes through fraud, but more often through mistake, that shares are issued as fully paid although the contract has not been properly filed, the result being that the shares were not fully paid as a matter of law. It was found that this produced so much injustice that, by the Act which I have just mentioned, the Court is now able to grant relief to persons who have taken shares thinking them to be fully paid, while, as a matter of fact, owing to the absence of, or some irregularity in, the contract, they were not validly paid up. But I need not say that, in the case of properly constituted companies, and of substantial concerns, every precaution should be, and, as a matter of fact, usually is, taken to prevent any errors as regards this matter.

I told you that a share could be paid for in cash or in kind, and could be paid for in kind if it was so provided by an agreement. It was at one time supposed that a share could be issued against a cash payment of less than its nominal amount, and that, notwithstanding, the share could be treated as fully paid if a proper contract to that effect was filed. In other words, it was at one time supposed that, by taking proper steps, shares could be issued at a discount; for example, that a £10 share could be issued as fully paid in consideration of the payment, say, of £7. 10*s*. Curiously enough, it was not until some years after the Act of 1867 had been passed, that the Court ultimately decided that

such a transaction was not legal. It must now be taken that shares in companies under the Companies Acts cannot be issued at a discount; and a moment's consideration shows that this result is almost a necessary consequence of the scheme upon which the Acts are framed. Every shareholder in a limited company has a limited liability; he purchases the benefit of this limited liability upon the clearly defined condition that, up to the limit, he is to be liable, and that his liability can be discharged only by a full payment in cash or in kind. If a share could be issued at a discount, the shareholder would get the benefit of limited liability without fulfilling the conditions; for he would discharge his liability by a payment of less than the full amount.

There are one or two points of detail in regard to shares with which I must now deal, and it will be convenient to take the points in the order in which they appear in Table A. Table A, you will remember, is a specimen form of Articles of Association, and, as I have told you, it is important from our point of view, from the fact that, as regards a great many matters connected with the administration of companies, the provisions of Table A are substantially reproduced in the Articles of Association of almost all companies. The first Article in Table A provides, "that if several persons are "registered as the joint holders of any share, any one of such "persons may give effectual receipts for any dividend payable "in respect of such share." A provision of that kind is almost always inserted in some shape or form in the Articles of a company, and it is usually inserted in a somewhat more elaborate form. The effect of the provisions as to joint holders is usually that where a share is registered in the names of two persons, the company is not bound to treat the share as though it were divided between the two, and it need not go into any question as between the joint holders or consider their relative rights. Where the articles contain such a provision as I have just read from Table A, the company can, for the purpose of paying dividends, treat any one joint holder as the agent of the other joint holder; and it is also usually provided that in the case of the death of one joint holder the company is to be entitled to treat the survivor as being the sole owner of the share. As a matter of fact, of course it rarely happens that the survivor of two joint holders is, as between himself and the representatives of his fellow joint-holder, the sole

owner of the share, for joint-holders are very often, perhaps usually, trustees of settlements or wills. But provisions of the kind that I have been mentioning simply carry out the scheme of the Act which (as I told you when we were considering the provisions of Section 30 of the Act of 1862) is, that as between the company and the shareholders, the company should be entitled to treat any person in whose name a share stands as being the absolute owner of that share. The same idea is found in the provisions usually inserted in Articles of Association on the subject of the death of a sole owner of a share. You will almost always find it provided that the company is to be entitled to treat the legal personal representatives of a sole owner as being the only person interested in the share. The provision usually made is that the legal personal representatives (by which I mean the executors or administrators) of the sole holder, can either have themselves registered as members in respect of the share, or can transfer the share to someone else.

In Article 4 of Table A, provisions are made with regard to calls upon shares. You will remember that a man who takes shares in a limited company becomes liable upon the winding-up to pay so much of the nominal amount of his shares as he has not previously paid. In a going company he will be liable to pay up the nominal amount of his share only to the extent and in the events provided by the Articles of Association. As a matter of fact, it is almost invariably provided in Articles of Association that the directors in the going company may, from time to time, make calls upon the members in respect of the amount for the time being unpaid upon their shares. Usually there is also a provision that each call is not to exceed a certain proportion of the amount of each share, and that certain intervals are to elapse between successive calls, the object being to make it easier for the shareholder to meet the calls upon him. In connection with calls upon shares, I must warn you that shareholders are very usually unwilling to pay money, and show great ingenuity in discovering reasons to justify them in refusing to pay their calls. It is very necessary, in making calls upon shares, to take care that every step is perfectly regular. If the call is in any respect irregular, the irregularity will form a defence to any action which the company may take to recover the calls. If, for instance, the directors were not properly elected,

or if at the meeting at which the directors decided to make the call a quorum was not present, a shareholder will have a good defence to any action for calls. He is only bound to pay the calls if they are properly made in accordance with the Articles of Association. If the call is irregular, if the so-called directors have not been properly elected directors, or if there is any other similar irregularity, he is entitled to treat the call as a nullity. It is exceedingly important, therefore, that care should be taken that there is no irregularity, in order that no difficulty may have to be faced if it becomes necessary to sue a shareholder for calls.

But, as you may well imagine, an action against a shareholder to force him to pay his calls is a very unsatisfactory remedy, from the point of view of the company. It involves legal proceedings, and legal proceedings involve costs. So you will usually find that in Articles of Association another means is provided by which companies can enforce calls without going to the expense and trouble of legal proceedings. You will usually find certain clauses generally known as the forfeiture clauses. The forfeiture clauses, as a rule, provide that if a member does not pay his call when the call is demanded of him, the directors are to give him a second notice asking for the call, and pointing out that in case the call is not paid the company will be in a position to forfeit his shares. Then, after a proper interval, the company has power to forfeit the shares. But this power depends entirely upon the provisions of the Articles of Association. If you wish to forfeit shares, you must read the articles of your company very carefully, and find out what their provisions are with regard to this point. Forfeiture, as a general rule, is only available for the purpose of enforcing the payment of a call. But in many modern companies you will find provisions, the object of which is to enable the company to enforce against a shareholder the payment of any moneys he may owe to the company, whether for calls or on any other account. The usual form is that the company is to have a first and paramount lien and charge upon all the shares registered in the name of a member for all moneys due to the company from him or his estate. Let me explain first what a lien is, and what a charge is. A lien is merely a particular kind of charge. A person who has a charge upon any property is entitled to have his debt (the debt, I mean, in respect of which he has the charge) satisfied

out of the property before anyone else is able to obtain satisfaction of his debt out of the property. The holder of a lien is simply a person who has property in his possession belonging to someone else upon which he has a charge. The most familiar instance of a lien is a banker's lien. If you deposit bonds with your banker and then overdraw your account, you will find that your banker will refuse to give up your bonds until you have repaid the overdraft. He is entitled to refuse to hand over your bonds, because he has by mercantile custom a banker's lien upon them; he has a charge over any property of yours in his possession to secure any moneys you may owe him. The effect of inserting in the Articles of Association a lien article of the nature that I have mentioned, is that the company will be able, in case a shareholder is indebted to it, to enforce a charge for the debt against the members' shares, and the lien clause, if properly drawn, will contain or be followed by provisions giving the company power, if necessary, to sell the member's share and to satisfy its debt out of the proceeds of the sale of the share. So you will see that if the Articles of Association contain the clauses which I have been describing, the company is, as against the member, in a position to take advantage of the value of the member's shares to satisfy any debts (whether upon calls or otherwise) which may be owing from the member to the company.

It will probably occur to you that it may sometimes be to a member's benefit that his shares should be forfeited. Let me give you an example. Suppose that a member holds a £10 share on which he has paid £2. He is under a liability to pay £8 more. If things are going badly, it may well be to his advantage to ask the company to forfeit his share. He may very likely have no objection to giving up all claim to his £2: that will already have been lost; but if his share is forfeited, he will or may be free from liability to pay up the remaining £8. A forfeiture under such circumstances would be a surrender rather than a forfeiture. I must warn you that the surrender of a share is ordinarily illegal. It is one of the principles that govern limited companies under these Acts, that such a company must not reduce its capital without taking certain measures pointed out by the Act, and, in particular, obtaining the sanction of the Court. Now the surrender of a share, as you will see, must

operate as a reduction of the capital of the company; and it follows that, *prima facie*, the surrender of a share is not legal. Under certain circumstances certain surrenders have been held to be legal, but these were peculiar circumstances into the details of which I need not enter. It is very necessary to warn you about the surrender of shares; for when the legal profession was not so familiar as it now is with limited companies under the Companies Acts, it was supposed that any surrender of shares was valid; and in consequence you will find in the articles of many companies provisions authorizing the directors to accept surrenders of shares. You must not suppose that provisions of that kind effectually authorize the directors to accept surrenders of shares. If the surrender of a share is illegal, no provisions in the articles will protect the directors, or effectually authorize them to accept the surrender. If that which the articles profess to authorize is illegal and outside the powers of the company, nothing in the articles will make it legal for the directors to do it.

I mentioned just now that it is one of the principles of company law that a company must not reduce its capital without the leave of the Court, and from this results another rule that I must mention, and that is that a company cannot purchase its own shares. The purchase by a company of its own shares is, as you will see, merely a reduction of capital: it must operate to extinguish the share, for the company cannot be a shareholder in itself. I must draw your attention to this matter for the same reason that I mentioned surrenders. The principle that a company cannot purchase its own shares was only established after a good deal of litigation, and you will sometimes find in Articles of Association provisions which profess to enable the directors of a company to purchase the company's shares on behalf of the company. Such provisions are ineffectual, and you must not think of founding any action upon them.

We will now turn to the subject of the transfer of shares. You will remember that in the first lecture we found that one of the reasons which helped on the growth of modern company law was the discovery that it was very desirable that partnership rights should be transferable as easily as possible. We also found that provision was made in Section 22 of the Act of 1862 for the transfer of shares. It is provided by that section that the transfer is to be in the manner provided by the regulations of the company. The effect of this is that the

regulations of the company can either make a share very easily transferable or can place narrow restrictions on the transfer. At one end of the scale you will find public companies in which the shares are very largely and very easily dealt with, the articles providing for the utmost measure of transferability, particularly if the shares are fully paid up. At the other end of the scale you will find many private companies with very few shareholders, and those, for all practical purposes, in the position of partners. In such companies it is very common to provide that shares shall only be transferred subject to narrow restrictions; for example, that they must first be offered to the other members of the company, or that the directors in succession are to have a prior right to purchase at a valuation. But you will find that in all companies the shares are in some measure transferable, and it will therefore be convenient that I should tell you what practically happens in the case of a transfer. Shares are transferred by an instrument in writing. You will find the form of such an instrument in Article 9 of Table A. The form in the article is substantially the ordinary common form with which the Stock Exchange is familiar. The instrument of transfer is usually merely a document stating that the transferor, in consideration of so much money, transfers to the transferee shares with such and such numbers in such and such a company. The articles usually provide that the transfer is to be signed both by the transferor and by the transferee. When the transfer has been signed, it is sent in to the company, with the certificate of the shares, stating that the transferor is the holder of the shares. As we saw in a previous lecture, this certificate is *prima facie* evidence of the transferor's title to the shares. The company's officers compare the tranfer with the certificate, to see that the transferor is the person named in the certificate as the shareholder, and, if all is in order, they submit the transfer to the next meeting of directors, and the directors will, in ordinary cases, pass the transfer. If there are any restrictions in the articles on transfer, the directors will have to consider whether the restrictions have been complied with, but subject to that they will pass the transfer and place the transferee's name on the register. They will then cancel the transferor's certificate and will issue a new certificate to the transferee stating that he is now the holder of the shares. It is the

practice on the Stock Exchange for the purchaser of shares to pay his money to the vendor on receiving from the vendor a properly executed transfer and the vendor's certificate; in other words, it is the practice for the purchaser to pay his money before the transfer is actually registered. The practice arises from the fact that shares dealt with on the Stock Exchange are usually shares in companies in which there are practically no restrictions on transfer. If a vendor holds 100 shares in a company, and is selling the whole of his 100 shares to a purchaser, no difficulty arises; but, as you will see, a difficulty may very well arise if the vendor has 100 shares and proposes to sell 60 to one purchaser and 40 to another. Suppose that A, holding 100 shares in a company, is selling 60 of them to X and 40 to Y. A can execute two transfers, one of 60 shares and the other of 40 shares, but he will not be entitled, according to the ordinary practice, to receive the purchase-money, unless he hands over his certificate with the transfer; and obviously he cannot hand his certificate to both parties. This difficulty has given rise to a practice which is commonly known as certification. The practice is, that the vendor takes his certificate to the company, and deposits it with the company's secretary, and, at the same time, produces two transfers, one of them (to go back to the concrete example which I gave above) a transfer of 60 shares to X, and the other a transfer of 40 shares to Y. The company's secretary keeps the certificate and writes upon each of the transfers the words "certificate lodged." That amounts to a representation by the company to the transferees that although the certificate is not produced to them the certificate is quite safe, because it has been produced to the company, and is in the custody of the officers of the company. If A then hands the transfers with the words "certificate lodged" upon them to the respective transferees, the latter will (according to the practice of the Stock Exchange) pay over the purchase-money. It is exceedingly important, as I pointed out to you on a previous occasion, that on making out certificates of shares the utmost accuracy should be observed; and it is equally important that, in placing this certification upon transfers the company's officers should exercise the greatest care. The statement "certificate lodged" is a representation to the transferees, which they are entitled to, and no doubt will, act upon, that the certificate, being *prima*

facie evidence of A's title to the shares, has been lodged with the company, and that it is, on the face of it, all in order. You will remember that I explained to you before, that on the principle of estoppel, if a company takes upon itself to make a representation of certain facts, and the person to whom the representation is made proceeds to act upon that representation, the company will be forced to make good the representation, although it may be erroneous. The officers of a company may, therefore, place the company under very serious liabilities if they make a mistake with regard to such a matter as certification.

In Article 11 of Table A, you will find a provision which is very usual and convenient, that the transfer books shall be closed during 14 days immediately preceding the annual general meeting in each year. The object of such a provision is to stop transfers for a time so as to enable the officers of a company to make up the books and to send the proper returns to the Registrar of Joint Stock Companies, without having continual variations among the shareholders during the period in which they are making up the returns.

So far, we have been dealing with questions relating to shares generally, but now I must say a few words about separate classes of shares. Table A, the specimen form of Articles of Association, is framed upon the footing that the company to which it relates has only one class of shares and that there are no differences between the shares. Now, as a matter of fact, it is a very common thing to have different classes of shares; in particular to have preference or preferred shares on the one hand and ordinary shares or deferred shares on the other, and it is important to consider what the relative rights of such classes of shares are. In the first place, I must warn you not to be deceived by the names attached to any particular class of shares. Nothing turns on the name at all. You must look in the Articles and the Memorandum of Association of the company to see what rights belong to the different classes. It often happens that shares are called preference shares, but when you look into the articles you find that their preference is of a very restricted nature. Sometimes it happens that shares are called deferred shares, a name which sounds very second-rate, but you may find in the articles, especially in companies where the deferred shares have been taken by the promoters, that, although the shares may be, in

some limited sense, deferred, they sweep up practically everything that is to be had. So the warning I want to impress upon you is, that where you are dealing with shares for the purpose of investment, you must be very careful to look in the memorandum and articles to find out exactly what the rights are which are conferred upon the different classes. Sometimes the differences relate only to dividends; for example, one class may be entitled to a dividend out of the profits of the year before the other class takes any dividend. But you will often find other differences too. Shares are frequently issued with restricted voting power, and sometimes, especially when it is intended to issue them to officers or employees of a company, without voting rights at all. Sometimes a preference share will have a preference not only as to dividend but also as to capital, which means this, that in the winding-up of the company, the holder of the share will have the nominal amount of it returned to him before any capital is returned to the holders of other shares. In the case of a company in which winding-up is either imminent, or at all events possible, a preference as to capital is a matter of considerable importance. On the question of the rights of different classes of shares arises a difficulty that I have already mentioned, and that is how far rights, which have once become vested in the holders of a particular class of shares, are alterable. It is settled, that if by the Memorandum of Association it is provided that certain classes of shares shall have certain rights, such a provision is unalterable. But if provision as to the rights of the different classes of shares is made by the Articles of Association it may be that the provision so made is alterable. You will remember that Section 50 of the Act of 1862 provides that the regulations of a company may be altered by special resolution. Everything in the Articles of Association comes, one would suppose, within the term, "Regulations of the Company," and therefore, one might infer that any provisions contained in the Articles of Association can be altered by a special resolution. The question is whether a company which has attracted capital upon the footing of giving the holders of that capital certain vested rights, can alter the rights of such holders, by the process of passing a special resolution. At present the decisions on the point are in a very unsatisfactory state; and no clear answer can be given to the question. I need not point out that the question is one of very great

importance, particularly to officers of companies with a large amount of capital to invest in Stock Exchange securities. If you have to form an opinion as to the advisability of investing money in any particular class of shares, it is of the utmost importance to know whether you will really get the rights which that class of shares, for the moment, carries, or whether those rights are liable to be taken away by a special resolution of shareholders over whom you will have no control, and in whose proceedings you may very likely have only a very restricted right of voting.

We have just been considering the question of the alteration of rights, as between the holders of existing shares. I must now say a few words as to the alterations of capital, not as between different classes of shareholders, but generally. In the first place, a company can increase its capital under Section 12 of the Act of 1862. That Section also enables an alteration of capital by the consolidation of shares, and you will find in the Act of 1867, Section 21, that this is supplemented by a provision that, under certain restrictions, shares can be sub-divided. Increase of capital, although it is, of course, a matter of importance, is a comparatively simple matter, but I cannot say the same as to the reduction of capital. I have already told you that a company cannot reduce its capital except under certain restrictions and in the manner authorised by the Acts; and in particular, a company cannot reduce its capital without coming to the Court, and obtaining the leave of the Court. A reduction of capital is usually, as you will see, a kind of liquidation, a sort of modified winding-up. If the reduction of capital takes the form of returning capital to the shareholders, what has happened is, that part of the capital of the company has been so judiciously employed that the company is in a position to shut up that part of its undertaking and to return to the shareholders the capital that was subscribed for that part of the undertaking. But, if as is much more frequently the case, the reduction of capital assumes the form of writing-off some loss which the company has sustained, that again is clearly only a modified form of winding-up. The company treats a particular part of its undertaking as having been unsuccessful; it cuts the loss, it abandons that part of the undertaking on which the loss has arisen. The reduction of capital is governed by Section 9 of the Act of 1867, supplemented by various Sections in the Act of 1877.

I shall have something to say about it later in connection with winding-up. I will now only pause to say, that under Section 9 of the Act of 1867, a company can only reduce its capital if it is authorised to do so by its regulations as originally framed, or as altered by special resolution. If, therefore, in your Articles of Association, there is no power for your company to reduce its capital, it must pass two different special resolutions. It must pass a special resolution altering its articles, before it can deal with the reduction of the capital at all, and then it must pass another special resolution effecting the reduction. Each special resolution requires two meetings—first, the meeting at which it is passed, and secondly, the meeting at which it is confirmed. You would think, *prima facie*, that in a case such as I have mentioned, it would be necessary to have four meetings in order to reduce capital. But three meetings will do. At the first meeting you will pass the resolution altering the articles. At the second meeting you will confirm it, and at the same meeting you will also pass the resolution reducing the capital. At the third meeting you will confirm this last resolution. It is very important to remember that you must alter the articles first; if you do not, the reduction will be invalid, and when you have gone through the elaborate processes which are necessary for securing the sanction of the Court, you may find that your reduction is invalid, that no sanction can be obtained, and that you must begin all over again.

I must now turn to consider a few points relating to those very important persons who are usually called directors, and I must say in passing, that there is no magic in the term "directors." In some companies—especially in semi-philanthropic companies—the directors are called "the council;" but whether the directors are called "the council" or are called directors is a matter of no importance. The persons to whom the supreme management and administration of the company is entrusted by the constitution of the company must be treated as directors whatever they are called. Now at the outset, we are met with a very curious fact, which is, that there is nothing, either in the Companies Acts or in Table A, to make it necessary for a director to be a member of the company. As a matter of fact, in the vast majority of companies, the Articles of Association provide that the directors are to be members; and in most companies the articles provide

that no one can be elected a director unless he holds, as a qualification, a certain number of shares. The question of qualification is an important matter for a director, for often the articles provide that a member who is elected a director, and who accepts the post, is to be deemed to have taken his qualification shares, though, in fact, he has never applied for them. So a person who has been elected director of a company may find that the mere fact of his election may have saddled him with the shares which he ought to have taken as his qualification. As regards persons dealing with directors, it does not matter much whether a director has taken up his qualification or not. Let me draw your attention to Section 67 of the Act of 1862, the effect of which is, to put it shortly, that any director who is appointed a director at a meeting of the company of which minutes have been properly kept, and whose appointment appears on the minutes, is, as regards the outside public, to be regarded as a director, notwithstanding that he may not be properly qualified. But I need not say that it is of the utmost importance that every care should be taken that directors are properly qualified; for although their acts may be valid as regards outsiders, notwithstanding the absence of a proper qualification, they may be invalid as regards members; and if unqualified directors make a call, they may find that the call is invalid, with the consequences which I have previously pointed out. As regards the election of directors, you will find in Articles 58 to 64 of Table A, provisions which are commonly reproduced in the articles of companies. Of course you ought to make yourselves thoroughly acquainted with the provisions relating to the election of directors in the articles of any company with which you are connected; but, as a matter of fact, in an old-established and successful company, questions as to the election of directors do not often arise. In such a company the directors are usually, in practice, a self-elected body. The old directors recommend new directors when there are vacancies, and new directors so nominated are usually elected. Indeed, the position of the directors, as regards the candidature of new directors, is often strengthened by provisions in the articles, that no person shall be eligible as a director unless either he is recommended by the existing directors, or some considerable notice has been given of his intention to present himself as a candidate. The object is to prevent new directors from being

foisted upon the company by a snatch vote at a perhaps sparsely attended meeting.

We now come to the question of directors' powers: and this question is not only difficult, but is continually arising in practice, and takes perpetually varying forms. The importance of the question is, that if the directors exceed their powers, they may find themselves under immense liabilities. Directors of large companies find themselves daily concerned in transactions in which large sums are involved, and they ought to remember, though, happily for the smooth conduct of business, they very rarely do remember, that they may easily make some mistake in their powers which will result in their being personally liable to pay or to replace some of the large sums involved. I have been able to tell you more than once, in the course of these lectures, to look at the articles of your company if you want to see what is or is not to be done in a particular matter; but, unfortunately, in regard to the powers of directors, it is often useless, and sometimes misleading, to look at your Articles of Association. You will see how this is when I tell you what are the various questions which you have to put to yourselves when you are considering whether a particular act is within the powers of your directors or not. In the first place, you must remember that directors cannot have power to do a thing which the company has no power to do; or, to put it in legal language, an act which is *ultra vires* (or outside the powers) of the company, must necessarily be outside the powers of the directors. Let me give you an example: We have seen that a company cannot purchase its own shares. It may happen that your articles may contain a provision that the directors shall have power to purchase the company's shares. The presence of such a power in your articles is by no means impossible, for it is only in comparatively recent years that the principle that a company cannot purchase its own shares has been clearly established. But this provision is absolutely useless. No limited company can purchase its own shares, and therefore no such company can authorise its directors to purchase its shares on its behalf. So that the first question you must ask yourselves when you are considering whether a particular act is within the powers of your directors is, whether the act is one which is contrary to the general law of companies? When you have got over that question, and

satisfied yourselves that there is nothing illegal in the act, the next question you must ask yourselves is, whether the act is one which the company, having regard to the provisions of its Memorandum of Association, can do? Suppose that the Memorandum of Association states that the objects of the company are to carry on the business of life assurance, but makes no reference to fire insurance. The directors cannot carry on any fire insurance business on behalf of the company, even though the articles provide that the directors should, in certain contingencies, carry on some such business. Such a provision, professing, as it does, to authorize something which is outside the scope of the memorandum, is a useless provision. If the directors are so unfortunate as to enter into any fire insurance contract, they will find that they are personally liable on the contract, and that the company have nothing to do with it, and have no liability in respect of it.

Suppose, however, that you have satisfied yourselves that the proposed act is, first, not illegal, and is, secondly, within the scope of the memorandum, there is still another question to face, and that is, whether the articles give the directors power to do the particular act. This question is usually answered fairly easily. In most companies you find an article framed in a rather general form, stating that the directors of the company are to be at liberty to exercise any of the powers of the company except such as must, under the Companies Acts, be exercised by the company in general meeting. That is a very usual form of article, and enables the last question to be easily answered. But you often find after this general article another article, stating that in particular the directors are to have power to do various things, particulars of which are set out at length. The reason for a clause of this kind is, that directors have a great affection for seeing their powers in black and white. They like to be able, when they are asked to undertake some operation, to find some express power in the articles authorising that particular action. As a matter of fact, such an article as I have mentioned is exceedingly dangerous, for this reason: that however carefully the article is framed, you may be pretty sure that, somewhere or other in it, some provision will creep in professing to give the directors power to do something which they cannot do. The longer and more elaborate the clauses are, the greater the chances that it contains something "*ultra vires*" of the

company; and if so, the article simply becomes a trap. The directors see that the article authorises the particular act, and very naturally infer that they can do it. But, of course, if the act is "*ultra vires*" of the company the directors cannot, and must not, do it, whatever the articles say. That is the reason why you ought to be exceedingly careful in deducing any theory as to the directors' powers from an article of that kind. It may be that the article is all right, and if it has been very carefully drafted, it will probably be all right; but having regard to the many doubts which still exist in a large number of cases as to the powers of companies, you can never be quite sure, however carefully the article has been drafted, that there will not be some trap in it.

I have spoken before in the course of these lectures about *ultra vires* and *intra vires* acts, and I have warned you of the great dangers of doing anything *ultra vires* of the company. But I have not yet, I think, told you exactly what the consequences are. Let us take an example, first, of an act *ultra vires* of the company. Suppose that directors pay a dividend out of capital; this is not infrequently done, sometimes through a fraud, usually through an error; but, as I shall show later on, when we come to deal with the subject of dividends, it is an act which is *ultra vires* of a limited company; it is beyond the powers of a limited company to use its capital in paying dividends. Suppose, however, that the directors do, as a matter of fact, apply capital in paying dividends, what is the consequence? The act of paying a dividend out of capital is *ultra vires* of the company; hence it follows that when the directors pay dividends out of capital they cannot be acting as agents of the company; they are exceeding their authority, and therefore their act must be taken to be done on their own responsibility. Their legal position, from a civil point of view, is precisely the same as if they had gone to the company's strong box and taken as many sovereigns as have been improperly spent in dividend, and placed the sovereigns in their own pockets. No doubt they have not put the sovereigns into their own pockets; they have distributed them among the shareholders. But that is no answer as against the company. As against the company the position is that they have taken the property of the company and applied it for purposes for which it is not legally applicable; from a civil point of view their responsibility

is just as great as if they had taken the company's money and had spent it for their own private purposes. It is quite true that, as regards the individual shareholder, the matter may be a little different. A director, who has paid dividends out of capital may be in a position to get back from the individual shareholder some part, at all events, of the money which he has paid to him by way of dividend. But, as regards the company, the director who pays dividends out of capital is liable to replace in the company's coffers the money which he took out and applied in the improper payment of the dividends. As you will see, this is rather a serious matter. The case I have just been putting to you is a case of an act *ultra vires* of the company. Let us now take as an example an act, which although it is within the powers of the company, is outside the powers of the directors. Suppose that a company's articles authorize the directors to borrow only up to a certain figure, let us say £100,000. Suppose that the directors proceed, notwithstanding that they have borrowed £100,000, to borrow more. What is the position? As against the person who has lent the money, the exact position depends upon what the provisions in the Articles of Association are. Every person dealing with a company, under the Companies Acts, is bound to make himself acquainted with the memorandum and articles of the company. If, on perusing the memorandum, he finds that the directors have no power to do that which they are purporting to do, he cannot treat the company as being bound by their act. If, however, he finds that the directors may have power, he is entitled to treat the company as bound by the directors' acts. For example, suppose that the articles provide that the directors shall not borrow more than £100,000 without the leave of the company in general meeting; suppose also that they do not obtain the leave of the company in general meeting, but, notwithstanding, they borrow £150,000. The lender may, nevertheless, treat the company as being bound by the directors' acts. He need not investigate the internal working of the company. For all he knows, the company in general meeting may have given leave for the further borrowing. Unless he knows that the leave has not been given, he is entitled to assume that it has been given, and he is safe. But what is the position of the directors? They, as between themselves and the company, have done something which they were not authorized to do;

they have committed a breach of their trust. They were authorized to borrow up to a certain figure; they have borrowed more; and the company has been damnified by the breach of trust, if, having regard to the circumstances, the lender is entitled to treat the company as being bound to pay the larger sum. The company can get damages against the directors for their breach of trust in exceeding their powers. Of course if, as a matter of fact, the company has got the extra £50,000 into its own coffers, it is not damnified; for although the directors' authority has been exceeded, still the amount borrowed has gone into the company's coffers and nobody is any the worse. But you can easily imagine circumstances in which the company may be damnified by directors exceeding their powers, and so far as the company is damnified, the directors will be liable to make good the loss.

There is one important point to remember with regard to an act which is *intra vires* of the company but is *ultra vires* of the directors. If an act is *ultra vires* of the company, the company cannot ratify it after it has been done: but if it is only *ultra vires* of the directors, and is within the powers of the company, it may be ratified. Suppose that the directors have had power to borrow up to a certain figure, but have exceeded the figure; the shareholders could, originally, if they had thought proper, have given the directors power to borrow up to the higher figure: and, therefore, by passing a proper resolution, they can ratify what the directors have done, which simply means that they can give the required authority retrospectively. But an act *ultra vires* of the company cannot be ratified, for the company obviously cannot authorize retrospectively an act which they could never have authorized at all.

I spoke just now of directors who exceed their powers as committing a breach of their trust; and this brings me to the question, how far directors are trustees. I daresay you know that in English law the position of a trustee is an exceedingly onerous one. He is a person who is in possession of, and has the care of, other persons' property; and this puts him under very grave obligations. If, even from mere ignorance, he falls short of the high standard of diligence and care to which he is bound to attain, he may find himself under a liability to his beneficiary. The liability of a director

towards his company is not quite the same. It is obvious that a director, in carrying on the business of a company, cannot take all those legal precautions which the trustee of a settlement, or of a will, can take in executing the trusts of the settlement or will. Practically, the law stands thus: a director must exercise the same care in carrying on the business of the company as a reasonably prudent man of business would exercise in carrying on a business of the same kind if the business were his own business. But there is one very important point in which the position of a director is quite analogous to that of a trustee. A director is the agent of a company, and he is therefore in what is called a fiduciary relation to the company. A person employed by another is in a fiduciary relation, that is to say, in a position in which the one party reposes trust and confidence in the other, and he must not make any profit in the matter of his employment without disclosing it to the person who employs him. Hence, any secret profit made by a director in the matter of his employment by the company must be refunded by him to the company, and the company can claim to have it refunded upon discovering that a secret profit has been made. A trustee who makes an undisclosed profit out of his trust makes it not for himself but for his beneficiary; and so a director who makes an undisclosed profit out of his directorship makes it for the company and not for himself. The same principle that applies to the directors applies to other officers of the company. The officers of a company are agents of the company, and are persons in whom the company reposes trust and confidence, and it follows that they must not make any profit, as such, without disclosing it to the company. Secret profits of all kinds can be recovered by the company from their agents, whether they be directors or other officers.

"THE COMPANIES ACTS."

FIFTH LECTURE.

V.—Management and Administration of Companies (*continued*).

In the last lecture we considered certain points relating to the liabilities of directors. I ought not to leave that subject without mentioning that in the year 1890 an Act was passed called the Directors' Liability Act. It is not, however, of much importance for our purposes: it relates almost entirely to the liability of directors for careless or fraudulent statements in prospectuses. I must also supplement what I said about the powers of directors by drawing your attention to the provisions made by the Companies Acts for the way in which contracts on behalf of the company are to be entered into by the directors. At common law, a corporation must enter into contracts under its seal. It is ordinarily not bound by any contract executed otherwise than under its seal. In the case, however, of companies under the Companies Acts, it is specially provided (Section 37 of the Act of 1867) that companies can be bound by contracts executed otherwise than under the company's seal. Where private individuals would have been bound by a contract under hand, a company can be bound by a contract signed by some person expressly or impliedly authorised to sign on behalf of the company; and in cases where a contract between individuals would be binding if entered into verbally, a contract may be entered into verbally on behalf of a company by any director or other

person who is acting under the express or implied authority of the company. You will also find that, under Section 47 of the Act of 1862, notes or bills will be binding on the company if made, accepted, or indorsed in the name of the company by a person acting under the authority of the company; and accordingly documents of that kind need not be under the seal of the company. So cheques, payable to the order of the company, are properly endorsed if they are endorsed by some director or other officer, who adds after his name the words "on behalf of," and then the name of the company. In connection with the use of the company's seal, I ought to tell you that a provision is usually made in the Articles of Association as to the way in which the seal is to be affixed to documents which are intended to bind the company. It is very usual to provide that the seal shall only be affixed in the presence of two directors and the secretary; and I must warn you that it is very important when a company is sealing documents, that care should be taken that all the formalities which are prescribed by its Articles of Association shall be properly fulfilled. The only other point about the seal that I need mention to you is, that under an Act of 1864, called the Companies Seals Act, companies incorporated in England, but carrying on business not only in England, but also in the colonies or abroad, can have duplicate seals for use out of the United Kingdom, and by Section 41 of the Act of 1862, provision is made that the company's seal must always bear the company's name.

We must now turn to a matter of considerable importance, and that is the consideration of the various securities companies can, or usually do, give to secure borrowed money. You will usually find in the Memorandum of Association of a company express provisions as to borrowing; but in the case of a trading company, the company will have power to borrow, notwithstanding that there may not be any express provision as to borrowing in its memorandum. For it is clear, looking at it from a commercial point of view, that a trading company cannot carry on its business without borrowing in some shape or form. I propose to discuss the various methods by which companies can secure money that they have borrowed. In the first place, I will say a few words about certain items of property which companies frequently mortgage, and as to which there are various peculiarities to be considered.

In the first place I will deal with uncalled capital. You are, by this time, well aware what uncalled capital is. It is capital which the company has the right, subject to the provisions contained in its articles, to call up from its shareholders. You will notice, therefore, that uncalled capital is not, strictly speaking, property; it is rather something which the company is able, by taking the proper steps, to turn into property. It is a right of getting property, rather than an actual right of property. At one time there was a good deal of doubt as to whether or not limited companies could mortgage their uncalled capital. It was suggested that the scheme of the act was that the uncalled capital should be, as it were, a security for the unsecured creditors, that the uncalled capital should be available in the event of winding-up, to discharge the liabilities of the company. However, it has now been decided, rightly or wrongly (and a great many people think it very unfortunate that it has been so decided), that companies can mortgage or charge their uncalled capital. The result of this, you will notice, is rather serious for the unsecured creditors. A company may have a large amount of uncalled capital, and it may induce people to trade with it on the footing that it has this uncalled capital. It may induce people to give it credit on the footing that they have this uncalled capital to look to. But it often happens, I might almost say that it usually happens, that when a company goes into liquidation, the uncalled capital is found to be charged, usually in favour of the debenture holders; and the effect often is that the unsecured creditors have no benefit whatever from it. I told you that the power to borrow was *prima facie* implied in the constitution of any trading company; but the power to charge uncalled capital is not *prima facie* within the powers of any company. Before a company can charge its uncalled capital it must be able to point to some express provision in its constitution entitling it to do so.

Then with regard to chattels—which I can define for our present purpose with sufficient accuracy as goods passing by delivery—there are certain peculiarities relating to mortgages by companies to which I ought to draw your attention. I daresay you know that there is a series of Acts called the Bills of Sale Acts, the provisions of which are rather complicated. But their general effect is, that an ordinary individual cannot make a valid mortgage of his chattels unless he makes it in

a certain form and registers it in a particular manner. The object of the Bills of Sale Acts is to protect persons of small means from the oppression of money-lenders. As you may imagine, persons who are in the habit of raising money upon chattels are usually persons who are not able to look very well after their own interests. But in the Bills of Sale Acts there is a provision that nothing in the Acts is to apply to the debentures of a company. It is not quite clear what the word "debenture" in the Act means, but for all practical purposes we may take it that when a company mortgages its chattels, the mortgage does not come within the Bills of Sale Acts. The effect of this is rather curious; it is, you will see, that a company has larger powers of mortgaging its chattels than an ordinary individual has.

Just now I used the word "debenture," and I must attempt to explain to you what a debenture is. Commercially speaking, a debenture is a very well-understood instrument, but, legally speaking, it is an instrument which it is very difficult to define. The Courts have over and over again said that, whilst this instrument or that instrument is a debenture, they are not prepared to define exactly what a debenture is, or what instruments fall within the meaning of the word "debenture." Debentures now-a-days are almost entirely confined to companies; but there is no reason why an individual should not issue a debenture as well as a company. As a matter of fact, I believe the Tichborne Claimant, many years ago, issued some securities, or bonds, which were called Tichborne debentures. A debenture usually creates a charge of some kind upon the property of the company which issues it; but occasionally debentures have been issued containing no charge. A debenture without a charge is simply a document by which the company either acknowledges that it is indebted in a certain sum, or covenants to pay a certain sum, whether on demand or at a future date. However, debentures now-a-days almost invariably contain a charge—in other words, the person who is entitled to the debenture is entitled to have the sum which is named in the debenture satisfied out of the property, whatever it may be, which is comprised in his charge before any other creditor can claim to take any part of the property. Now, in order that you may realise what a debenture is, let me first describe its physical characteristics. A debenture is nothing but a large sheet of paper, with a

little print on one side (the face) and a large amount of print on the other side (the back). On the face of the debenture you will generally find the name of the company, and various statements as to the amount of its capital, the address of its office, and so forth; and you will also find on the face an acknowledgement by the company that it is indebted in a particular sum, or a covenant by the company to pay a particular sum. This is usually followed by a clause stating that the particular moneys secured by the debenture are a charge upon certain of the property of the company; and then there usually follows a clause stating that the debenture is to be held subject to the conditions endorsed on the back. When you turn your sheet of paper over you will find on the back a number of conditions. These conditions very often begin by a condition stating that the holder of the debenture is to be taken to hold it subject to the provisions contained in a covering deed, or trust deed. The trust deed is a deed which is entered into between the company and the trustees for the debenture holders, and which generally contains elaborate provisions giving the trustees rights of entering upon the property of the company, and of realising the property of the company in case default is made in payment of the debentures. Then you will find on the back a provision that each debenture is one of a series of so many debentures, and that all the debentures of the series are to rank *pari passu*, and are to have equal rights as between themselves. Then will follow a clause which may take one of two forms—it will either provide that the company will treat the bearer of the debenture as the person who is entitled to the benefit of it; or, it will provide that the company is to keep a register of the names and addresses of the holders of the debentures, and that it will treat as the owner of the debenture the person whose name appears upon the register as the registered holder. If the former of these clauses is in the debenture, it is a debenture to bearer; if the latter of the clauses is contained in it, it is called a registered debenture.

Now, let me tell you, first of all, that a debenture is almost invariably one of a series, and let me explain to you what that means. I will assume that you know what a mortgage debt is. A mortgage debt may, for our purposes, be described as a debt which is secured upon property; that is to say, the property upon which the debt is secured is to be applied in

the first place in paying the debt before it is applied to any other purpose. That will be a sufficiently accurate description of a mortgage debt for our present purposes. Suppose that a company has created a mortgage debt of £100,000, that is to say, has mortgaged its property for £100,000; the mortgagee is entitled to have his £100,000 paid to him out of the property of the company before anyone else has his debt satisfied out of the property in question. As you may well imagine, it is not often that one comes across a person with £100,000 who is prepared to advance it upon a single mortgage; but what does very often happen is that there are one hundred people, each of whom is prepared to advance £1,000, and their advances, when added together, will make up £100,000. A debenture, then, from this point of view, is merely a share in a mortgage debt. If a company issues debentures to the extent of £100,000, it has laid itself under a liability to pay £100,000—not to one person, but, in shares, to each of the persons who have taken the debentures. If the denomination of each debenture is £100, you have 1,000 debentures of £100 each, which may be held by 1,000 separate persons, or may be held in varying amounts by various persons. So you see that a debenture holder is a person who, with a number of other people in the same position as himself, is part owner of a mortgage debt to the total amount of the debentures. You will now be in a position to understand the importance of the clause which you will find in a debenture, stating that the debenture is one of a series, and that the whole of the series rank *pari passu.* That merely states explicitly what I have been explaining to you, that each debenture holder holds, as between himself and his fellows, an aliquot part of one large debt, and that as between themselves the debenture holders rank equally. But let me impress upon you that the debenture holder is a creditor, and is not a shareholder. As we shall see later, having regard to certain provisions which are often put in debentures, the debenture holder has, to a great extent, a community of interest with the shareholders of the company; but you must remember that he is not a shareholder; he is not a partner in the concern; he is a creditor with certain defined, and sometimes restricted, rights. Now, the reason why debentures are so popular now-a-days is that they are very easily transferable from hand to hand. If a debenture is a bearer debenture—that is to say, if it

contains the clause which I spoke of just now providing that the company will treat the bearer of the debenture as the owner of it—the debenture may be dealt with very easily indeed. For instance: suppose that you hold a number of debentures, and that you have deposited them at your bank for safe custody, and that you wish for an overdraft from your bank. The bank will, under these circumstances, at once let you have the overdraft; for, as long as the debentures are in the bank's possession (they being bearer debentures), the bank can deal with them without going through any formalities of transfer or anything of that kind. So that, for the purposes of a commercial man who is likely to want to raise money at short notice without going through the formalities of transfer and mortgage and so forth, the ownership of bearer debentures is exceedingly useful. A registered debenture has advantages of a different kind. It cannot be dealt with so easily, for the title to it will depend upon the debenture holder being named in the register as holder of the particular debenture. The title to a registered debenture is, therefore, very analogous to the title to a share; it depends upon the registration in the proper register. This, of course, is not so convenient for the man who wants to raise money at short notice; but it is far more convenient, and far safer, for the ordinary investor, who does not usually want to realize his investment at very short notice. A bearer debenture is easily dealt with; but, if a thing is easily dealt with by its true owner, it is as easily dealt with by a thief. The danger of a bearer debenture is that if it gets into the hands of a dishonest person he will be able to make, for all practical purposes, as good a title to the debenture as if he were the true owner. But with a registered debenture this danger does not exist, as it can only be dealt with by the person who is the registered holder, and, unless there is deliberate forgery (which would hardly be likely to be successful, unless the company were implicated), the title of the registered holder to the debenture is, for all practical purposes, absolutely safe.

I have explained to you what a debenture is, and I must now go on to explain what debenture stock is. Debenture stock is a class of security which has become very popular lately, for various reasons, which I shall explain in a moment; but, from our point of view, it is not very different from

debentures. There are two sorts of debenture stock. There is perpetual debenture stock, and terminable debenture stock; and, I must tell you, that there is a question whether a company which merely has ordinary powers of borrowing has the power of issuing debenture stock. However, this is a question which does not often arise, because you will almost always find in the Memorandum of Association of modern companies power to issue debenture stock. Now, perpetual debenture stock is, in many respects, analogous to Consols. Let me explain to you what happens in the case of a new issue of Consols. The person who subscribes for £100 of Consols pays the Government £100, and in return the Government puts itself under liability to pay him a perpetual annuity (not a life annuity, but a perpetual annuity) of £2. 10*s*. or £2. 15*s*. for every £100. In the same way, if a company issues debenture stock, the transaction is, that the person who has subscribed for £100 of perpetual debenture stock pays his £100, and in return the company puts itself under the obligation of paying him a perpetual annuity of, say, £4, £4. 10*s*., or £5 for each £100. The difference between the Consols and the perpetual debenture stock (and it is a difference of considerable importance) is this, that the Government is not in the habit of going into liquidation, or going bankrupt; but, unfortunately, companies have a way, sometimes, of going into liquidation, and, if they do so, their property has to be applied in meeting their liabilities. Suppose you are the holder of perpetual debenture stock, and the company in which you hold the stock goes into liquidation, the effect of that will be that the company will cease to pay you the perpetual annuity which, according to your contract, you are entitled to receive. You will then be in a position to claim against the company for the loss that you have sustained by the cessation of your perpetual annuity. You will have to value your loss, and you will be entitled, if the company has enough assets, to have the loss made up to you. Now, on this a curious question arises. Suppose that the perpetual debenture stock is a 5 per cent. stock, and that you hold £100 of it. You paid £100 originally, and the company is bound to pay you £5 a year in perpetuity. If money has gone up in value, it may well be that your right to receive £5 a year in perpetuity is worth more than £100—say that it is worth £120. If the company goes into liquidation, will you be entitled to

claim £120, or only the £100 which you originally paid? Like so many of the questions that we have come across in our lectures, this is a question which has not yet been decided; and it would, therefore, be rash for me to suggest what the answer is. But I will go so far as to say that I think you could make out a very good case for claiming £120, and not merely £100. But, as I have said, the question is undecided; and I advise you, if you are investing in perpetual debenture stock, not to assume that you will, in case of liquidation, be able to claim more than the nominal amount of the stock which you hold. But whatever the amount is to which you may be entitled on liquidation, you will observe that, on liquidation, your so-called perpetual debenture stock comes to an end, for liquidation, as we shall see later, puts an end to the company for business purposes; and so perpetual debenture stock is a somewhat misleading term. But there is another sort of debenture stock, and that is terminable debenture stock; and, from a legal point of view, there is only a trifling difference between this and debentures. A terminable debenture stock is constituted by the company entering into a covenant with trustees for the debenture stock holders that they will, at a certain date, say 30 years hence, pay the debenture stock holder the principal which he has advanced to the company, and that, meanwhile, the company will pay a particular rate of interest upon that principal. Now, it is the practice for trustees for stock holders to issue to each stock holder, that is, to each person who subscribes to the stock, a certificate stating that he is the holder of so much of the debenture stock. You will see that a debenture stock holder, who holds a certificate of that kind, is, for all practical purposes, in the position of a debenture holder holding a debenture for the same nominal amount. The differences, so far as we need notice them, are three. The first difference is that the debenture stock holder has not received any direct covenant from the company. The debenture holder has usually received such a covenant, for, as we saw, such a covenant is usually contained in his debenture. A debenture stock holder can only get his £100 through the trustees, for it is with them that the company has covenanted to pay the principal of the debenture stock. That is one difference, and not a difference of very large importance. The second difference is, that the debenture stock can be transferred

in all sorts of different amounts, while debentures cannot be transferred or dealt with except in multiples of the nominal amount of each debenture. A £1,000 of debentures in £100 debentures can be split into ten portions of £100 each; but £1,000 of debenture stock could be transferred in numberless different amounts, £150 to one man, £30 to another, £820 to a third, and so forth. However, it is not found convenient to deal with debenture stock in small sums, and you will often find it provided that the stock can only be dealt with in multiples of, say, £50, and then the stock can be split to the same extent as if it were represented by debentures of £50 each, and to no greater extent. The third difference is this, that a debenture stock holder only holds a certificate, while a debenture holder holds a debenture. From a legal point of view that difference is small, but, from a practical point of view, the difference is great, because in a debenture there are always a large number of conditions and a great deal of print, while a debenture stock certificate is simply a small slip of paper with comparatively little on it; and, although you may say that the amount of print on a particular instrument is not a matter of much importance, still, when one is dealing with enormous sums of debentures or debenture stock, very often running into hundreds of thousands, and sometimes into millions, every economy in printing is a matter of importance. This is, perhaps, one of the most important reasons why debenture stock is now more popular than debentures. The reason, however, is disappearing. The Stock Exchange finds that the debenture stock holder is quite satisfied with a mere certificate, even though he finds on his certificate only the absolutely necessary information. The debenture holder finds set out in his debenture all the conditions on which he holds his debenture. This difference gives certain facilities to unscrupulous companies. They can put in the debenture stock deed all sorts of restrictive provisions, which will naturally affect the stock holder's right, but which he will never see. In order to prevent this, the Stock Exchange is beginning to enforce a rule by which, in effect, all the provisions in the trust deed liable to affect the stock holder, or the value of the stock, have to be stated on the back of the certificate. The effect is, that debenture stock certificates are becoming almost as bulky as debentures are; and one cannot help thinking that the result will be that the

public will return to debentures rather than insist upon having debenture stock.

I have spent some time explaining the characteristics of debentures and debenture stock, because they are the most usual securities issued by companies, and are very important, from the point of view of the investor. A company can mortgage its assets in much the same way as anyone else; and companies often issue documents which, although not called debentures, are, for all practical purposes, debentures with fancy names. Let me give, as an example, prior lien bonds. For some reason or other, the average investor seems to consider prior lien bonds as a much higher class of security than debentures; but, as a rule, a prior lien bond is simply a debenture issued by a company which has got into difficulties, and has obtained from its former debenture holders power to issue bonds to come in front of the debentures, in order to raise money to keep things going.

I pass now to the subject of floating charges. You will often find that a debenture is secured by a floating charge over all the assets of the company. Let me try to explain what this means. It is clear that, if a company creates a charge over all its assets the charge would, in the ordinary sense, paralyse its business. Suppose, for example, that the company carries on a large drapery business. If it charges its assets, in the ordinary sense, for the repayment of borrowed monies, the borrowed monies will be a charge upon all the items of its property. Suppose that the drapery company has ten yards of valuable silk, and that all its assets are charged with the repayment of borrowed money. If the charge was an ordinary charge, any person to whom the silk is sold would receive the silk charged with the debt. It is perfectly obvious that a charge of that kind would be practically impossible in the case of a trading company, and that has given rise to the practice of creating what are called floating charges. A floating charge is a charge which is subject to the right of the company to carry on its business in the ordinary course. When a company gives the debenture holder a floating charge, the arrangement is that the company shall be at liberty, so long as it carries on its business in the ordinary course, and until it winds up, to use its assets for the purpose of its business. It may, in the ordinary course of business, get rid of its assets, and then receive the purchase

money; it may, in the same ordinary course, spend the purchase money in buying new stock. In fact, the company is to be at liberty to carry on the business in the ordinary course, but the moment that it goes into liquidation, or that, for some other reason, the security of the debenture holder becomes enforceable, the right of the company to deal with its assets is to stop, and from that moment the debenture holder is to have a fixed charge on the assets. The effect of his having a fixed charge on the assets is that he will be entitled to have the assets realised, and to be paid his money out of the proceeds. So that a floating charge enables a company to carry on its business in the ordinary course. You will notice that the effect is, that the debenture holder's interests become closely assimilated to those of the shareholder. The company is able to carry on its business in the ordinary course, without interference from the debenture holder, but it may be that the company is carrying on its business at a disadvantage. If that is so, the debenture holder cannot interfere, provided that the business is carried on in the ordinary course; but, clearly, the security for the debentures may be very seriously diminished. In the same way, if a company carries on its business to advantage, all the advantages which accrue will go to strengthen the security of the debenture holders. The debenture holder will not be so closely concerned in the matter as the shareholder, for the shareholder's annual dividend depends on the success with which the business is carried on. But the debenture holder's interest will be analogous to that of the shareholder in this sense, that he will be affected by any increase in the value of the company's business, and he will also be affected by any loss the company may sustain in the ordinary course of carrying on the business. But I again remind you that, notwithstanding, the debenture holder is a creditor; he is not a shareholder.

I have just been discussing some of the various liabilities that companies may be under to creditors, secured creditors especially. But it remains now that we should consider the liabilities that a company may come under to its shareholders. The form that the liability of a company to its shareholders takes is this: annually, or at regular intervals, the company takes stock of its profits, and divides its profits in dividend amongst its shareholders. It divides its profits, and the profit so divided is called dividend. Now I have already told you

more than once that it is contrary to the whole scheme of the Companies Acts, that a company should reduce its capital without the leave of the Court, and without going through the various proceedings prescribed for that purpose by the Acts. Now it is clear that if a company pays dividends out of capital it will be reducing its capital: it will be taking part of its capital and dividing it amongst the shareholders. So the first point to remember in connection with dividend is that the company must not pay dividends out of capital. It would seem to follow that the company may pay dividends out of profits. This will very often be the case, but as to this you must look to the Articles of Association of your company to see what they provide as regards the payment of dividend. You usually find that the articles provide that the company may divide the profits arising out of the business. Now the profits arising out of the business of a company need not necessarily be the same thing as the whole of the income of the company. For example, take the case of an insurance company, which, in the course of the year, has carried on the business of insurance, and in the carrying on of that business has made, let us say, £50,000 of profit. Suppose, also, that part of the company's property consists of its head office, occupying, let us say, a valuable site in the middle of the City. Suppose that the head office was, at the beginning of the year, worth £100,000, and that in consequence of some new railway, or the opening of some new street, the company finds, at the end of the year, that the office, formerly worth £100,000, has risen in value, and is worth £150,000. When the company makes up its balance sheet, if it sets the proper values on its various assets, it will find that it has, at the end of the year, not only the £50,000 profit, which it made in carrying on the business of insurance, but a further £50,000, which is the difference between the value of the head office at the beginning of the year, and its value at the end of the year. The company's income has been, in a certain sense, not £50,000, but £100,000. If, however, the articles provide that the company can divide in dividend only profit arising out of its business, it will be able to divide the £50,000, which it made by carrying on the business of life insurance, but it will probably not be able to divide the £50,000 which it has made by the increase in the value of its capital assets. It may be, that by altering the articles in the proper way, the company can take power to divide

that further £50,000; but without some such alteration, a division of the extra £50,000 will probably be improper. Now the principle that dividends must not be paid out of capital would seem to be an easy one to understand, but I would warn you that it is very difficult to apply. Suppose that a company is formed to carry on the business of coal mining, and in the course of the year raises and sells a certain amount of coal. The colliery makes a profit: but in a sense part of the profit has been taken out of capital. The company applied its capital originally in buying the coal mine; and every ton of coal it takes out of the mine goes *pro tanto* to diminish the value of the mine. Very difficult questions have arisen as to how far a colliery company can divide its gross revenue obtained by raising coal without recouping to capital the diminution in the value of the mine caused by the taking out of the coal. If the articles of the company are properly framed, it will probably be found that the company can only divide in dividend the revenue, after making proper allowance for depreciation. This is a very important matter, for this reason: that, if the directors, by some chance, whether through a mistake in law, or any other mistake, pay dividends out of capital, they will find that they are liable to replace, out of their own pockets, the dividends so paid. It may be that they are entitled to recover from the shareholders the dividends improperly paid to them, but even this is by no means clear, and I must warn you that the utmost care must be taken never to pay dividends out of capital, or the consequences may be exceedingly serious. It is obvious that before paying any dividend the directors must take stock of the company's affairs, and see what has been the result, I mean the financial result, of the operations of the company during the year. In other words, there must be proper accounts and a proper audit. Often the accounts of companies are taken and audited only once a year, but it would obviously be very inconvenient to pay dividends only once a year. This would involve keeping a considerable amount of profit locked up for some time, and consequently you will almost always find provisions in the Articles of Association enabling the directors to pay what are called interim dividends. An interim dividend is a payment on account of the dividend of the year. Of course the payment of any interim dividend is, to some extent, a matter of risk, for,

until the accounts are finally made up, it is impossible to be absolutely certain that the company has made a profit available for dividend. But here the directors are assisted by the doctrine of averages, and, as a matter of fact, in a properly conducted company, it is not difficult to see, without going minutely through the accounts, when a certain amount of profit has been made; and if directors only take care, when paying interim dividends, to take a somewhat pessimistic view of the profits made, they really do not run any serious risk.

I have spoken already of the various classes of shares, and I must now say a few words as to the preference attaching to preference shares in respect of the payment of dividend. A preference as regards dividend is the most usual form of preference attached to preference shares. You will usually find that upon the issue of a preference share it was provided that it should be entitled to dividend at the agreed rate (say 5 per cent.) before any other dividends should be paid to the holders of any other class of shares. Probably you will, in connection with preference shares, have come across the terms cumulative and non-cumulative, and I must explain the difference between a cumulative dividend and a non-cumulative dividend. Suppose that preference shares are issued on the footing of having a preferential dividend of 5 per cent., but that in the first year the company does not earn sufficient profit to pay the whole of the 5 per cent. on the preference shares. The company evidently cannot pay the 5 per cent., for the preference shareholder is, after all, a shareholder, and the money paid to him is money paid by way of dividend; and dividend must not be paid out of capital. If there are not sufficient profits, the preference shareholder must go without his dividend—at all events, for a time. Suppose that in the second year the company makes profits. The right of the preference shareholder is to have 5 per cent. each year; and, if in the first year he received, let us say, only 3 per cent., he will be entitled *prima facie* to have the remaining 2 per cent. of the first year made up to him out of the profits of the second year; in other words, *prima facie* his preference share carries a cumulative dividend. However, preference shares are often issued on the footing that they are to be non-cumulative; let me give you an example to show what this means. Take the same case of preference shares with a 5 per cent. dividend, and assume that it has been provided

that the shareholder is to be entitled to his dividend for each year out of the profits of that year only. Then, in the first year, if there are only sufficient profits to pay 3 per cent., the preference shareholders will receive only 3 per cent. But in the second year there may be sufficient profits to pay not only the 5 per cent for that year, but also the 2 per cent. arrears for the former year. But, if the shares are non-cumulative, the preference shareholder will not get the arrears. The profits of the second year will be applied in paying him 5 per cent. for the second year, but his arrears in respect of the first year will have gone, and he will not be entitled to have them paid to him.

Having regard to the importance of not paying dividend out of capital, very careful attention must be paid to the provisions in the Articles of Association relating to accounts and audit. Curiously enough, the Act itself makes no provision whatever for accounts or audit. Since the year 1879, limited banking companies have had to have an annual audit; but the ordinary company, so far as the Act goes, need not have any audit at all. As a matter of fact, it is almost invariably provided in the Articles of Association that a proper audit shall be held, and you usually find that it must be held once a year.

In a former lecture I mentioned incidentally the various statements and returns which ought to be sent in to the Registrar of Joint Stock Companies by companies constituted under the Companies Acts; and I also mentioned shortly the various statements and returns which have to be made by insurance companies under the provisions of the Life Assurance Companies Act. I do not propose to go through the list of these statements and returns again, but I will draw your attention to one or two points which I have not yet mentioned connected with the returns to be made under the Life Assurance Companies Act of 1870. You will find there provisions for sending in various returns at stated periods—some annually, some only at intervals of five years; and you will also find that, under Section 11, copies of these statements and returns have to be sent not only to the Board of Trade, but to every shareholder and policyholder of the company who applies for them. You will see, if you look at Section 2 of the Life Assurance Companies Act of 1870, that the expression "policyholder" includes "annuitants." Under Sections 12

and 13 of the same Act you will find provision that companies which come within the Life Assurance Companies Acts, but are not constituted under the Companies Act of 1862, are to be under certain obligations, one obligation being to keep a shareholders' address book. That, you will remember, is provided for by the Act of 1862, as regards all companies incorporated under that Act. Section 13 of the Life Assurance Companies Act, 1870, provides that companies not registered under the Acts are to have their deed of settlement printed, and are to send copies of their deed of settlement to any shareholder or policyholder who applies for a copy. Here there is rather a curious point: under the Companies Act any company registered under that Act must send copies of the memorandum and articles, if requested, to any member; but if an insurance company is not incorporated under the Companies Act it must send a copy of the deed of settlement, if so requested, not only to every member who applies for one, but to any policy holder and annuitant who requires one. So, by registering under the Act of 1862, a life insurance company finds itself, at all events as regards this small matter, under less onerous obligations than before.

Before leaving this part of the subject, I propose to say a few words on an Act of considerable importance to life assurance offices, and that is the "Payment into Court" Act of 1896. I must first explain what payment into Court means. It has long been the practice of the Court of Chancery, or to give it its modern name, the Chancery Division of the High Court, to allow trustees to pay money into Court when there is any doubt as to the ownership of the money, or as to what the various rights are of the various beneficiaries. Paying the money into Court means paying the money into the Bank of England to the account of an official of the Court. When the money has been so paid into Court it can only be dealt with under an order of the Court, and the trustee who pays the money in is free from responsibility as to the division of the money, the Court undertaking to decide to whom the money belongs. The scheme of the Payment into Court Act of 1896 is to put life assurance companies into the same favourable position as trustees as regards payment into Court. If a company has any doubt as to the persons entitled to any policy monies, it may pay the policy monies into Court, and thus is freed from any obligation in respect of them. If any

person considers that he has any claim to them, he must apply to the Court for payment out, and the Court will decide who is entitled to the money. As to the details of payment into Court, you will find some rules in Order 54 C of the rules of the Supreme Court. These rules provide, in the first place, that when a company wishes to pay monies into Court, it must file an affidavit by one of its officers describing the policy, stating the various claims that have been sent in to the company, and stating that the directors consider that no sufficient discharge can be obtained for the policy monies except by payment into Court. The company must also submit to pay any future interest, or any costs which the Court may see fit to order it to pay. The company must also undertake to forward to the proper official any future claims which may be sent in to it. The company is not allowed to take advantage of the Act if there is any action pending in relation to the policy monies. If any claimant has actually started an action the company must abide by the result of the action, and cannot get rid of its responsibilities by paying the money into Court. The company must give notice of the payment into Court to every one who makes any claim to the money; and when the payment into Court has once been made, no application with regard to the funds need be served upon the company; but the company may possibly be ordered to pay the costs in connection with the claim, and if it is ordered so to do it will be bound to do so, having regard to the undertaking to that effect contained in the affidavit already mentioned. There is one point to notice, and that is that the company must pay into Court the whole of the policy monies; it must not deduct from the policy monies the expenses of payment into Court. These expenses will, I presume, be borne by the company, and represent the price it pays for being allowed to escape the responsibility of deciding to whom the money belongs.

"THE COMPANIES ACTS."

SIXTH LECTURE.

VI.—Winding-up and Re-construction.

COMPANIES go into liquidation, or, to use the more technical expression, are wound up, for various reasons. Suppose that a company has been formed for carrying out a building speculation. The speculation may have been successful, and, if so, the company will find itself with funds sufficient to pay up all its liabilities and to enable it to return to the shareholders all their capital and also a share of profit. In such a case, the company, although it is rich, will nevertheless have to go into liquidation; for it is only in liquidation that it can distribute its capital amongst its shareholders. Another case is this: a speculation of the same kind may have been entered into, but it may have turned out unsatisfactorily; the members may see their capital gradually disappearing. For the moment, the company may be able to pay its debts; but the speculation may, nevertheless, seem likely to be a losing one for the shareholders, and they may wish to put an end to their joint adventure. In either of these two cases which I have put, the proper course to adopt is, for the company to pass, under Section 129 of the Act of 1862, a special resolution for voluntary liquidation. But, as you may easily imagine, there are many other cases in which a company has to go into liquidation, cases in which the company is unable to meet its liabilities. In the two

cases that I put just now, no one was concerned but the members; the company in each case had sufficient funds to pay its debts, and it was a question merely as between the members themselves whether or not liquidation was advisable. But, suppose that the company finds itself unable to meet its liabilities? It can again have recourse to Section 129, and it may either put itself into voluntary liquidation, by passing a special resolution, or, it may (under the same Section), do so by passing an extraordinary resolution. An extraordinary resolution is, so to speak, the first half of a special resolution. It is a resolution which, if it were confirmed at a second meeting, would be a special resolution; but an extraordinary resolution requires one meeting only to pass it. A company can put itself into liquidation by extraordinary resolution only if the members resolve that the company cannot, by reason of its liabilities, continue its business, and that it is advisable to wind up the same. So that, as you see, the Act provides machinery by which a company can put itself into liquidation by a single resolution passed at a single meeting, if its creditors are pressing upon it and the members consider it unable to meet its liabilities. Voluntary liquidation is intended, primarily, for cases in which the creditors are not mainly concerned, cases where there will be enough to pay the creditors. The scheme of the Act, as regards liquidation, is that, as soon as a company has passed its liquidation resolution, the business stops, except so far as it is necessary to carry it on with a view to beneficial realization. The corporate state of the company continues. The company appoints its liquidator, and he has the general supervision of the liquidation; but, notwithstanding the appointment of a liquidator, the directors' powers may be allowed to continue if the company think fit. The duties of the liquidators are, to make the necessary calls on the members, to collect the assets of the company, to apply the assets in paying the debts, and, when all the debts have been paid, to realize the remaining assets and divide all the profits of the company amongst its members. You will find provisions as to all these matters in Sections 131 to 133 of the Act of 1862. While the voluntary liquidation is in progress, the members of the company are to be summoned to a general meeting once a year, and the liquidators are to lay before the general meeting a statement of the progress of the liquidation, and of all their acts and dealings with

regard to it. If, at any time, in the course of the liquidation, any difficulty arises, the liquidators, or any member of the company, can, under Section 138 of the Act of 1862, apply to the Court and obtain directions as to what ought to be done. But, in a voluntary liquidation, there is no means by which a creditor can interfere. There is, it is true, a provision in Section 135 of the Act of 1862, that the Company can, if it thinks fit, enter into an arrangement with the creditors, enabling them to have a certain voice in the conduct of the liquidation. But it is rare for recourse to be had to this Section, and, for all practical purposes, it may be said that, so long as voluntary liquidation continues, the creditor can do nothing. If the company does not pay its debts, the creditor can bring an action against it. Its corporate state continues just as if it were not in liquidation, and the creditor can bring his action regardless of the liquidation; but the Act enables the liquidator to apply to the Court to stop the action, and the Court will do so, if proper provision is made to enable the creditor to get his rights. Voluntary liquidation, as I have been describing it to you, is very analogous to the arrangement of the affairs of an individual debtor out of Court. As you know, when a man is unable to meet his creditors, it often happens that, instead of making the man a bankrupt, and going through the somewhat expensive proceedings necessary for that purpose, his creditors meet together and come to some arrangement, embodied, as a rule, in a deed of arrangement, under which a trustee is appointed to realize the debtor's property and pay the debts out of the proceeds. This is a voluntary arrangement, outside the dominion of the Court.

But it may very well be that the position of a company is such that voluntary liquidation is practically impossible. It may be that things have been going badly for some time, so badly that the members of the company have, for all practical purposes, lost all hope of getting any return of the money that they have invested in the company. In such a case, it may well be that the ordinary creditors and the debenture holders between them will have to sweep up all the assets in order to satisfy their claims, and that the members will have no interest left in the concern. In such cases as that voluntary liquidation is obviously unsatisfactory. The whole point of voluntary liquidation is that the members are in

the saddle, that the liquidator acts as the servant, and under the direction of, the members, and that creditors can scarcely interfere at all. In such a case as we have just been considering, a creditor has two courses open to him. He may go to the winding-up Court and ask for a supervision order. The effect of a supervision order is that, when it has been made, the liquidator is to act under the supervision of the Court; in practice this merely means that a creditor can, at any moment, go to the Court and get the Court to give directions to the liquidator as to how he is to act. The members are still in the saddle, for most purposes of the liquidation; but the creditor can, by taking the proper steps, exercise a certain amount of control. This scheme is advantageous where the members are still beneficially concerned in the assets of the company, but it is not satisfactory where the members have lost all interest in the assets. To meet such a case as that, there is another course open to the creditor: he may present a petition for the compulsory winding-up of the company.

The compulsory winding-up of a company is very analogous to the bankruptcy of an individual carried through in the Bankruptcy Court. Prior to 1883, the bankruptcy of an individual was considered a matter entirely between the individual and his creditors. Until 1883, the trustee in bankruptcy was a person nominated by the creditors, and the whole thing was carried through under (it is true) the control of the Court, but without any substantial interference by any Government department. In 1883, the Legislature took, as regards bankruptcy, a new departure. The basis of the Bankruptcy Act of 1883 is that bankruptcy is no longer to be a matter merely between the bankrupt and his creditors. The Board of Trade steps in, and the Official Receiver, who is a Board of Trade Official, takes the place, for many purposes, of the trustee in the bankruptcy. It is the duty of the Board of Trade and their officials not only to see that the bankrupt's assets are duly administered, as between the various creditors, but also to investigate the bankrupt's affairs, and to see whether he has committed any fraud, or any offences against the Bankruptcy Acts, such as not keeping proper books, or trading when insolvent. In fact, the Board of Trade exercises a kind of general censorship over the bankrupt and his proceedings.

Until the year 1890, liquidations under the Companies Acts were conducted in the same way as bankruptcies were before 1883. But in 1890, the Legislature took, with regard to the winding-up of companies, the same departure as it had taken in 1883 as regards bankrupts. The Act passed in 1890 for winding up companies applies, for all practical purposes, only to compulsory orders. On the making of a compulsory order for the winding-up of a company, the Official Receiver becomes the liquidator of the company, and it is the duty of the Official Receiver, not only to protect the assets of the company, and see that they are properly applied, having regard to the rights of the creditors and the members, but also to hold an investigation into the promotion and formation of the company, and to take such steps as he may think proper to bring to light any delinquencies that may have been committed, and make any fraudulent promoter disgorge his plunder. The Official Receiver is, to a great extent, uncontrolled by the creditors. He has the interests of the community to consider; and if he, in the interests of the community, thinks that investigation should be made into the circumstances attending promotion of a company, it will be his duty to make such investigation, whatever view the creditors of the company may take. In fact, the scheme of the Act of 1890 is, that the Board of Trade, through their officers, are to institute an investigation into what I might almost call the morals of the liquidating company. There has been a good deal of debate as to whether the departure is a wise one or not. On the one hand, there is the view that persons who are in the habit of dealing with companies in their everyday business are more competent to conduct company liquidations than the Board of Trade are. Probably the Board of Trade official has not always the kind of commercial knowledge and experience which would best enable him to form a sound judgment on questions connected with commercial speculations. On the other hand, one cannot help seeing that it is to the benefit of the community that there should be some officer whose duty it is, and who has the power, to investigate all these matters, and see that any delinquencies that may have been committed are dragged into the light of day. But, after all, these are questions of policy and not of law, and it is not necessary for us to discuss them.

The scheme of the Companies (Winding-up) Act, 1890, is, that as soon as the Court makes an order for compulsory winding-up, the Official Receiver, who is an officer of the Board of Trade, becomes the liquidator of the company. It is his duty to make out a statement of the affairs of the company, and to call upon the directors and the officers of the company to give him the necessary information for the purpose. He also summons meetings of the creditors and of the members of the Company; and the creditors and the members, at their separate meetings, vote as to whether they desire that the Official Receiver shall continue to be the liquidator of the company or whether they wish that some other person should become the liquidator in the place of the Official Receiver. The Official Receiver presents a report to the Court, in which he states the result of the meetings of creditors and members; and it is then for the Court to judge whether, under the circumstances, it is preferable that the Official Receiver should remain liquidator, or that an outside liquidator should be appointed. When the Act first came into force, it was very largely the practice to continue the Official Receiver as liquidator, but it is now, perhaps, less customary to do so, and more the practice to have an outside liquidator. It is found that a Board of Trade official, whatever his merits may be, is not always the best person to carry on a commercial concern. But, even if an outside liquidator is employed, the Official Receiver is always behind the liquidator. It is the Official Receiver's business to investigate the affairs of the company and make up his mind whether or no there has been fraud in its promotion or formation, and whether the directors and officers of the company have acted in such a way as to make it advisable, in the interest of the creditors, to bring proceedings against them for damages or compensation for breaches of trust or misfeasance. The Official Receiver approaches all those questions from a somewhat public point of view. The liquidator should consider the interests of the creditors and the members. But the Official Receiver, as I pointed out, represents, so to speak, the public conscience.

With regard to the business details of the liquidation, I need not trouble you at any length. As regards business details, the position of the liquidator in a compulsory liquidation is much the same as his position in the voluntary liquidation, except that as regards any important step or considerable

sale or realization he has to obtain the sanction of the Court. The sanction of the Court does not mean necessarily that the matter goes before the winding-up Judge. There is an officer called the Registrar, before whom details of this kind come; he, in ordinary cases, represents the Court for the purpose of deciding what steps shall be taken for the purpose of realizing the assets, and so forth.

While I am on the subject of compulsory winding-up proceedings, I ought to say a few words about the preliminary steps that are necessary for obtaining a compulsory order. The remedy of a creditor of a company, who is unable to obtain payment of his debt, is to present a petition to wind up the company. The Court has no jurisdiction to wind up a company, unless a petition is presented, and the Court, as you may imagine, is anxious to discourage the presentation of more petitions than are necessary. It is the rule, therefore, that if after one petition has been presented, another creditor presents a petition, the later petitioner will not have his costs allowed to him out of the assets of the company. You are aware, no doubt, that in all legal proceedings the thing to which lawyers attach the greatest importance is the question of costs; and so, as you may imagine, the effect of the rule, that a subsequent petitioner is not to have his costs paid out of the assets of the company, is that lawyers hesitate to advise the presenting of a second petition when a petition has already been presented. This used to be utilized by companies in a rather curious way. If a company found itself getting into a bad way, it found a friendly creditor and induced him to present a petition. Then any other creditor, who might be thinking of presenting a petition, would find another petition before him, and would consequently hesitate considerably before presenting a second petition, through the fear of not getting his costs. When, however, the petition came into Court, the friendly petitioner would either keep away altogether, or would appear and state that his demands had been satisfied and that he wished to withdraw his petition. This would, of course, be quite satisfactory to the company, but not to the genuine creditor. For the latter would have allowed valuable time to slip away, and could procure a winding-up order only by starting away with the rather long process of presenting a fresh petition and waiting for it to come on. However, the employment of a "pocket petitioner,"

as the friendly creditor used to be called, has now come to an end. For a new rule has been made, to the effect that if a petitioner wishes to withdraw his petition, any other creditor can claim to be substituted as petitioner in the place of the man who seeks to withdraw, and the petition will go on with the new petitioner substituted for the old one.

It is often of very great importance that a particular petition should succeed and an order be made upon it without the necessity of a fresh petition being presented. The reason is that the winding-up commences as from the presentation of the petition, and not from the date when the order is made. Any transaction that has taken place between the presentation of the petition and the making of the order is void, unless the Court otherwise orders. As you may imagine, when a company is *in extremis,* all sorts of intrigues are going on. People often want to get transactions through while the company is still a going concern. Often many people are interested in defeating a particular petition, not because they hope to keep the company ultimately out of liquidation, but because it is to their interest to prevent the liquidation dating back to the particular date on which the petition was presented.

Let me now tell you, shortly, what the various grounds are upon which a winding-up petition may be based. If you will look at Section 79 of the Act of 1862, you will find that a company may be wound up if its business is at an end, or if it is unable to pay its debts, or if the Court is of opinion that it is just and equitable that it should be wound up. The last expression will probably strike you as rather vague, but it has been interpreted by the decisions. The Court is ready to regard it as just and equitable that a company should be wound up if it turns out that the circumstances are such that the objects with which the company started have practically come to an end, and, in a business sense, have ceased to be possible.

Then what is the criterion by which the Court judges whether or not a Company is unable to pay its debts? If you look at Section 80 of the Act of 1862, you will find that a creditor may serve on the company what is called a statutory demand for his debt. If that demand is not satisfied within three weeks, the company is, by the statute, to be deemed to be unable to pay its debts. But it is not necessary to serve the statutory

demand if the petitioner can prove by any other means that the company is unable to pay its debts; for example, if he can show that the bills of the company are dishonoured as they fall due.

Section 82 of the Act tells us who is qualified to present a petition for winding-up. It may be presented, of course, by a creditor, or it may be presented by the company; but the cases in which a company petitions for a compulsory order are very rare. If a company wants to go into liquidation it has at hand the convenient machinery of voluntary winding-up. A petition may also be presented by a contributory or member of the company, but the right of a member to petition is limited by Section 40 of the Act of 1867, which provides that a member cannot petition to wind up a Company unless he is either an original shareholder or has held his shares for six months. You will easily see what the object of this Section is: it aims at preventing persons from buying a few shares in a Company in order to make themselves unpleasant, and to be in a position to present a petition for the winding-up of the company. The limit of six months insures (at all events, to some extent) that a member who presents a winding-up petition is a *bonâ fide* shareholder, and not a man who has become a member for the purpose of making himself unpleasant.

In the remarks which I have been making about winding-up petitions, I have been dealing with the case of ordinary companies under the Companies Acts. But I must tell you that the winding-up provisions of the Companies Acts apply not only to companies constituted under those Acts, but, generally speaking, to any other commercial companies. This is effected by Section 199 of the Act of 1862. There are certain companies which cannot be wound-up under the Companies' Acts, such as railway companies incorporated by Act of Parliament. But, generally speaking, you may take it that all companies, whether formed under the Companies Acts or not, are liable to be wound up under the Companies Acts.

As regards Life Assurance Companies, there is another ground besides those which I have mentioned on which they can be wound up. If you will look at Section 21 of the Life Assurance Companies Act of 1870, you will find that if a Life Assurance Company is found to be insolvent,

on taking into account its contingent liabilities (*e.g.*, on policies and annuities) and not merely its actual accrued debts, it may be wound up, and a petition for winding it up can be presented not only by a creditor but by a policyholder. Under the Companies Acts, only a creditor can petition, or a member, but as regards the Section of the Life Assurance Companies Act of 1870 to which I have just been referring, a petition can be presented by a policyholder who, of course, may not be a creditor at all, since his policy may not be, and probably is not, yet payable. Further, if you look at Section 2 of the same Act, you will find the expression "policyholder" is defined as including "annuitant." So that a Life Assurance Company is in this position, that if it is insolvent, on taking into account its various liabilities on policies and annuities, any policyholder or annuitant can present a petition to wind it up.

If you will look at Section 4 of the Life Assurance Companies Act of 1872, you will find another respect in which the provisions of the Companies Acts as regards winding up are somewhat enlarged in relation to life assurance companies. That Section, in substance, provides that if the affairs of a number of insurance companies are mixed up, and one of them is put into liquidation, any of the others can be put into liquidation, although for the moment they may not be insolvent. The reason for the insertion of that provision is that, shortly before the date of this Act, there had been a number of liquidations of insurance companies; and the liquidations were very much complicated by the fact that the various companies had in many cases gone through processes of re-construction and amalgamation, and the result was that the affairs of the various companies were involved together; and it was found exceedingly difficult to wind up one of the companies without winding them all up.

Let us return to the case of ordinary companies. I have told you that there are three forms of winding-up; and the question arises, if in a particular case different views are taken as to which is the preferable form of liquidation, how the choice is to be made between them. As regards creditors, it is provided by Section 145 of the Act of 1862, that the fact that a company is in voluntary liquidation is not to prejudice the right of any creditor to insist on a compulsory liquidation if the voluntary liquidation would prejudice his rights; and,

by Section 91 of the same Act, it is provided, in effect, that the Court in coming to any decision in relation to winding-up may have regard to the wishes of the creditors and members of the company. As a matter of fact, it is the practice of the Court to pay very considerable regard to the wishes of creditors and members; and, in fact, when a creditor presents a winding-up petition, and it turns out at the hearing that a very considerable majority of creditors take a different view of the situation, and do not wish that a compulsory order should be made, but prefer that the liquidation should be voluntary, the Court has regard to their wishes and permits the liquidation to be conducted in accordance with the views of the majority. When the Act of 1890 was passed, a tendency began to show itself in the Court to consider other matters besides the wishes of the creditors and the members. The Court began to look at winding-up questions more from the public point of view; and there have been cases in which compulsory orders have been made against the wishes of practically everyone concerned, where a case was made out for investigation. However, the tendency merely comes to this, that nowadays if the Court sees that a company has been doing very badly, and that there are all sorts of promotion scandals and so forth at the back of the company's affairs, it will be anxious, if it can, to make a compulsory order, in order that the Official Receiver and the Board of Trade should have an opportunity of looking into the matter.

I do not propose to trouble you with the details of winding-up as far as relates to the realization of assets and so on, but there are three matters on which I would like to say a few words as to the effect of winding-up. Take, in the first place, the business of the company. The liquidators can carry on the business of the company, but only to a limited extent. They must carry on the business of the company only so far as may be necessary for its advantageous winding-up. The liquidator is not entitled to go on carrying on the business in the ordinary course. His business is not to trade but to realize; though, of course, in the case of a trading concern the assets cannot be realized at any moment, and the trade must be carried on to some extent in order to enable the assets to be satisfactorily got in. Then a second point I wish to mention is the question of the valuation of liabilities. I must call your attention to the provisions of Section 158 of the

Act of 1862. That Section roughly comes to this, that when a company goes into liquidation all its creditors must be treated as coming in and requiring payment at that moment. Of course, when a company goes into liquidation there may be creditors with actual debts, and there may also be persons who have no actual debts, but are future or contingent creditors. Take the case of a Life Assurance Company. There may be persons whose policies will not mature for some time, and annuitants with claims for future payments of their annuities. But when the company goes into liquidation, all claims must be treated as crystalizing, so to speak, at the moment when the order for winding-up is made; and an estimate has to be made, as far as possible, of the value of these various claims and debts at that moment, and the assets have to be distributed on the footing of that valuation. Then the third matter I have to mention is how actions and distresses against the company are to be dealt with. The scheme of the Companies Acts, as regards liquidation, is that all the creditors and all persons having claims against the company must come in under the winding-up, and must be treated, as far as possible, on an equality. It is obvious that it would not be possible to treat creditors on an equality, if they were allowed at their own pleasure to bring actions and levy distress against the company. The Acts contain various provisions which enable the Court to stop any creditor who takes any proceedings which will or may interfere with the equal rights of his fellow creditors.

I have already told you that, when a petition has been presented, any transaction on the part of the company is void, assuming, of course, that the petition results in a liquidation. But you may well imagine that, important as it may be to protect a company in regard to transactions which take place while a petition is pending, it is often just as important to protect it against transactions which take place before presentation of petition, but at a time when the company is practically *in extremis*. Section 164 of the Act of 1862 provides for this, by making any fraudulent preference on the part of the company void. In bankruptcy, if an individual, within three months before his bankruptcy, prefers any creditor by paying that creditor's debt, in such a way as to prejudice the rights of other creditors, the payment will be void, and the money will have to be refunded. The Section which I have just mentioned reproduces this in the

case of companies. The effect is that, if within three months of winding up the directors of a company have paid any creditor in priority to other creditors, the creditor will have to refund what has been paid to him. This is simply an extension of the principle I mentioned just now, that all creditors are to be on an equality as from the commencement of the winding up, and not only from the commencement of the winding up, but as regards transactions which have taken place when the winding-up was imminent.

Of course there are certain classes of creditors that are preferred to other creditors; I refer to secured creditors. A creditor with a security for his debt has, in effect, a preference over a creditor that has no security. But this security is often not so valuable as it appears at first sight, particularly if the security takes the form of a debenture. A debenture holder often finds, when he comes to realize his security, that he is very much hampered by what is called "the majority clause." It was found when debentures became common, that there was no convenient machinery for binding an obstinate minority of debenture holders to accept a reasonable compromise of their rights, even if the compromise were approved by a large majority, and were obviously proper and beneficial. Now, the "majority clause" is a provision inserted either in the debenture or in the debenture trust deed, to the effect that a compromise sanctioned by a majority (usually a three-fourths majority) of debenture holders is to be binding on all the debenture holders. The object of this clause is, of course, to prevent an obstinate dissentient from obstructing a reasonable arrangement, and it frequently operates very beneficially. But this is not always the case. It sometimes happens that a majority of the debenture holders consists of persons who, whether as shareholders or otherwise, have interests which conflict with the real interests of the debenture holders as such; and it therefore happens, occasionally, that the clause is used, in effect, to take away the rights of a minority in the interests of some different class of persons altogether. However, if a man takes debentures which contain a clause such as I have spoken of, he puts himself into the power of his fellow debenture holders, and, if they use their power to his detriment, he must not, I suppose, complain.

Now I ought to say a few words as to the way in which,

in practice, ordinary debts are proved against a company. Notices are sent out to the effect that the creditors must claim by a certain time; and the creditor has to make an affidavit stating what his debt is, and estimating its value, if it is not a debt presently payable. There was considerable difficulty at one time about estimating the value of a contingent debt, but it is now decided, by the case of "Hardy *v.* Fothergill," in the House of Lords, that every claim must be treated as capable of estimation. A great many claims, one would think, are very difficult to estimate; but, after all, one hears now-a-days of all sorts of chances and possibilities being estimated; and certainly the decision of the House of Lords seems to be in accordance with the views of modern valuers. At any rate, the creditor must put an estimate of some sort or kind in his claim. Now let me give you an example of this. Suppose that I have taken a lease of a house. I am liable, on the covenants of the lease, to pay the rent. If I assign the lease to someone else, the assignee will be liable, in the first instance, to pay the rent; but I shall still remain liable to the landlord if the assignee fails to pay. Suppose that I have assigned a lease to a company, and the company goes into liquidation. I have a claim against them; my claim is to be indemnified by them in case I have, through their default, to pay the rent. When I come to prove my claim against them, I have to value the chance that the company, or the person to whom the company assign the lease, may, at some future period, fail to pay the rent. From the business point of view it is, of course, very difficult to estimate such a claim as I have been mentioning, but some estimate must be made; for, if I let the winding-up go on, without making my claim, I lose my remedy; for, when the company has been wound up it is dissolved, and my claim for indemnity, even if it were not barred by the fact that I have not proved it at the proper time, becomes futile.

In connection with proof of debt, there is another matter to be mentioned, and that is the question of set-off. It often happens that a creditor of a company is in the position of also being a debtor to the company. If he claims against the company and the company has a claim against him, there is no reason why money should be handed from one side to the other. In an ordinary case one claim can be set off against another. But there is a very important exception to this. If

the creditor is a person who is liable in respect of capital uncalled on his shares, he is not in a position to set off; and a moment's thought will show you how this is. It is one of the principles of the Companies Acts, that uncalled capital must be paid up in full; and the effect of a set-off would be that the creditor, instead of paying up his capital in full, would be paying it by releasing a claim against the company; the claim, if the company is insolvent, is clearly not worth twenty shillings in the pound. The effect of a set-off in such a case would be that the man would not pay up his share of the uncalled capital in cash.

Before leaving the question of winding up, I must say a few words about a matter in which the public take a good deal of interest; I refer to the misfeasance of directors and officers of companies. When a company goes into liquidation, the first things that happens is, as a rule, that charges are made against the directors. There is special machinery provided by the Act of 1890 for recovering damages or compensation against directors and officers for any breach of trust or misfeasance which they may have committed. In order to assist such claims there is machinery provided by the Act for having the directors and the officers of the company publicly examined. The liquidator always has power to conduct private examinations of any person who is connected with the company, and who has any knowledge of the affairs of the company, but it was a new departure to insert, in the Act of 1890, provision for public examination. Public examination is a proceeding of a penal character. The object is two-fold—first, to obtain information so as to enable the company to bring actions against directors and recover damages from them; secondly, to deter company promoters and others from committing frauds and breaches of trust in connection with companies. I believe that, as a matter of fact, the average company promoter is very much afraid of publicity, and that the public examination provisions in the Winding-up Act of 1890 have had a considerable deterrent effect.

There is one more matter which I ought to mention before we leave the subject of winding up. Suppose that all the creditors have been paid and there are still assets of the company left, what is to be done with the surplus? The surplus belongs to the members of the company, and difficult

questions have often arisen as to the exact way in which the surplus should be divided. I need not stop to examine those questions now; I will only say this, that if the members of a company have paid up different amounts on their respective shares, the surplus assets must be applied in the first place in levelling down the shares, that is, in returning to any member, who has paid more than his fellow members, the amount which he has paid in excess of what his fellow members have paid. When that has been done, and all the members are on an equality, the surplus assets must be divided between them in proportion to the nominal amount of their shares.

We now come to the subjects of re-construction and amalgamation, which are closely akin to winding up. Amalgamation is a term which there is great difficulty in defining. I should be almost disposed to call it a slang term, but for the fact that it appears in the Life Assurance Companies Acts of 1870 and 1872, and I suppose that one is not justified in applying the word "slang" to any word which the Legislature has used. As a matter of fact, it is exceedingly difficult to say what is, and what is not, amalgamation. Amalgamation no doubt involves the idea that two companies shall become blended into one in some way or other; and the form which the blending takes is almost invariably either that one company sells to the other company the whole of its undertaking and assets, or that the two companies join in selling their respective undertakings and their respective assets to a third company. In any case, amalgamation for our purpose may be treated as one form of re-construction. Re-construction again is almost a slang term. It is a word which does not appear in the Acts at all, though it is very familiar in practice. When a company goes into liquidation it will usually have a considerable amount of assets which are not readily realizable, but which, if slowly and carefully realized, would probably have considerable value. The best way of securing their realization to the best advantage is usually to re-construct the company. You must also remember that human nature, especially in connection with companies, is exceedingly sanguine. People always hope that the formation of a new company and the transfer of the assets of the old company to the new company, with a re-adjustment of the capital, and a modification of the creditors' rights, will get over all

difficulties and enable everything to go well. As a matter of fact, I believe that, in a great majority of cases, re-constructed companies come to grief within a short period. However, re-construction is very popular nowadays, and very usual.

There are some forms of re-construction which do not involve winding up at all. If in the memorandum of a company it is provided that its objects are to be, amongst other things, to sell its undertaking and assets, the company can, while still a going concern, sell the whole of its undertaking and its assets for cash or, if the memorandum so provides, for shares. The company will, of course, not be able to distribute the cash or shares among the members without going into winding-up; for such a distribution would be equivalent to a return of the capital, and that is not authorized by the Acts. But if the memorandum contains the proper provisions, there is nothing to prevent the sale. One would have supposed that in the Memorandum of Association there would be inserted only the objects of the company, and it certainly seems strange that it should be an object of the company to commit suicide, for that is really the effect of a sale of all its undertaking and assets. But, however that may be, it is now well-established that the sale of a company's undertaking is perfectly valid if the Memorandum of Association of the company authorizes it. A sale of that kind does not, of course, bind the creditors; that is to say, after such a sale the company still remains bound to apply its assets (that is, the purchase money received on the sale) in paying off its creditors; it cannot, by a sale transfer its creditors to the new company. But, as a rule, this causes no great difficulty. In the large majority of companies the creditors fall into two classes; they are either trade creditors, whose debts run off fairly quickly, or else they are secured creditors who hold debentures or debenture stock. A company can generally get rid of its debenture-holders by forcing them, under a majority clause, such as I have already explained to you, to take, in exchange for their debentures, securities of the new company. As regards trade creditors, it is generally easy to arrange with them, either by paying them off to some modified extent, or by inducing them to look to the new company for the payment of their debts. If re-construction is carried out on these lines, winding-up will only come when it is necessary to divide up the purchase money. A transaction of this kind is very

similar to amalgamation under Section 14 of the Life Assurance Companies Act of 1870. That Section provides for amalgamation while the company is a going concern. Any amalgamation under that Section must be sanctioned by the Court, but no winding-up is necessary.

There is another proceeding which is practically a modified form of re-construction, but which does not involve winding up. I refer to reduction of capital. I have told you more than once that the capital of a limited company must not be returned to shareholders or otherwise tampered with, but, under the Acts of 1867 and 1877, the capital of a limited company can be reduced by taking proper proceedings and obtaining the sanction of the Court. The reduction of the capital of a company is practically equivalent to a winding-up on a small scale. Suppose that the reduction takes the form of writing off capital which has been lost, the transaction is really that the company winds up that particular part of its undertaking which has been unsuccessful. If the reduction takes the form of returning to the shareholders capital no longer wanted for the purpose of the company (which is, however, a somewhat rare form of reduction) it is practically a winding-up of a successful portion of the company's undertaking. In either case the reduction is in effect a winding-up *pro tanto*; and before sanctioning reduction, the Court always insists, if the reduction affects creditors, on being satisfied that the creditors are paid off or that they are willing that the reduction should be carried through. One little point I must mention, and that is, that if a company's capital has been reduced it is forced to tack on to the end of its name for a short time, the words "and reduced," in order to give notice to persons who deal with it, that its capital has been reduced.

Now let us consider what can be done in the way of re-construction with winding up. Hitherto we have been dealing with re-construction without winding up. When a company is once in liquidation, it can take advantage of the provisions of Section 89 of the Act of 1862. That Section provides that the Court can, at any moment, stay all proceedings in the winding up. If the winding up is stayed, the company will go on just as if it had never been in liquidation at all. In other Sections of the Act (*e.g.*, S. 136, S. 159, and S. 160), there are various provisions, enabling

liquidators to enter into arrangements with creditors, which, in some cases, and under some circumstances, are binding on the minority of creditors, if approved of by a proper majority. I need not trouble you with the details of the sections. But the position, broadly speaking, is that, if a company finds itself in liquidation, and is able to stave off its creditors, or enter into some arrangement with them under some of these various provisions, it can take advantage of Section 89 to obtain an order staying the winding up; and it will then be able to go on as before, with, of course, the advantage of having dealt with its creditors, and of having, perhaps, had some of its debts written off. These provisions have been extended by an Act called the Joint Stock Companies Arrangement Act, passed in 1870. This Act applies when a company is in winding up, and enables the Court, on a proper case being made, and on certain consents from creditors being secured, to sanction a scheme of arrangement and making it binding on all the creditors and members of the company.

There is another form of re-construction which I must not forget to mention. A company may go into liquidation, and then transfer all its assets to a new company. I spoke before of a re-construction carried out by a sale under the provisions of the Memorandum, and a transfer of the assets to a new company. Such a sale, as we saw, does not necessarily involve liquidation; but, when a company finds itself in liquidation, it can, under Section 161 of the Act of 1862, sell all its assets to another company, notwithstanding that the Memorandum of Association of the selling company contains no power of sale. A sale of this kind, just like a sale under a power in the Memorandum, does not operate to bind the creditors. But, having regard to the other provisions of the Acts, to which I have already referred, and having regard, especially, to the provisions of the Joint Stock Companies Arrangement Act of 1870, it is often possible for a company to take advantage of Section 161, by selling all its assets under that Section to a new company, and then to take the proper steps, under the other provisions of the Act, to bind the creditors to accept some compromise or arrangement as to their debts.

So far I have been dealing with the re-construction of ordinary companies under the Companies Acts. But there are

certain points which I should mention in regard to life assurance companies. I have already mentioned Section 14 of the Life Assurance Companies Act of 1870, which enables amalgamation under certain circumstances. This Section applies, so the Courts have decided, only if the companies which desire to amalgamate have power to do so under their regulations. There is a curious point in regard to this Section which is a warning never to assume that the Legislature necessarily means what it says. There is one clause in the Section which runs thus: "No company shall amalgamate with another, or transfer its business to another, unless such amalgamation or transfer is confirmed by the Court, in accordance with this Section." At first sight, one would suppose that this meant that a life assurance company must either carry through an amalgamation under this Section or must not carry it through at all. As a matter of fact, in more than one case, amalgamations of life assurance companies have been carried through apart from this Section, and without the sanction of the Court. For, when a company has once gone into liquidation, the Companies Act of 1862 applies to it, and it can then take advantage of the provisions of the Section 161, which enables the liquidator to sell the assets to a new company. I believe it has several times been assumed (probably correctly) that the sale by the liquidator, under Section 161 of the Act of 1862, is valid, although Section 14 of the Act of 1870 says that no amalgamation shall take place unless confirmed by the Court under Section 14.

There is another matter in which a Life Assurance Company has an advantage in re-construction over ordinary companies. The Legislature has been very tender to life assurance companies. You will find that Section 22 of the Life Assurance Companies Act of 1870 provides, that in the case of a life assurance company which has been proved to be insolvent, the Court need not make a winding-up order but may reduce the company's contracts. A reduction of contracts means that the Court orders that each creditor, policyholder, or annuitant shall, instead of being entitled to have his whole claim or debt, be entitled only to a proportion of it. The Court has no power to reduce contracts in winding up; it can only reduce contracts as a substitute for winding up.

In connection with amalgamations there is a matter which frequently arises and which I must not pass over without a

few words ; and that is novation. Let me explain to you what novation is. Suppose that I am a policyholder in company A, and that company A transfers its business to company B, and that I continue to pay my premiums to company B. Is that evidence that I have agreed to discharge company A and to look henceforward to company B, and to company B only, for the payment of my policy ? That is a question which was discussed at great length in a great many cases, and the decisions on it were very conflicting. If I had intended to discharge company A, and to look thenceforward to company B only, my intention was, in legal language, to novate my debt, that is to say, to replace by former rights against company A, by new rights against company B. One would think, at first sight, that a policyholder who gave up paying his premiums to company A, and instead paid them to company B, intended to look to company B for payment of his policy. But the argument in such cases always was that the payment of the premiums to company B was, or might be, a payment to them as agents for company A, in which case the payment would of course be no evidence of an intention to release company A, but rather evidence to the contrary. However that may be, the question has ceased to be as important as it once was, for by Section 7 of the Life Assurance Companies Act of 1872, it was provided that a payment of premiums to the new company should not be evidence that the policyholder had abandoned his rights against the old company. This is a Section which you will do well to bear in mind, if you have anything to do with the re-construction of a life assurance company.

This brings to an end what I intended to say to you about re-construction and amalgamation, and I propose to utilize the very few moments that are left in making a very few remarks on certain projected reforms in connection with companies. The effect of the Companies Acts has been to give opportunities for business investment, and to some extent for speculation, to large classes of persons, who are not of business habits, and have no business experience, and no business capacity. Companies formed under the Companies Acts obtain certain privileges from the State, and it is only fair that the State should have the right—and it undoubtedly has the right—to put them to some extent into leading strings. There has, however, been a tendency of late years to put companies

more and more into leading strings, in order to protect the small investor and other persons who, without business capacity, use the Companies Acts for purposes of speculation. The question arises how far it is advisable that the State and the Legislature should interfere with companies for the purpose of protecting such persons as I have mentioned. There is, I think, a general feeling (in some parts of the commercial world at all events) that if people who are not familiar with these matters will insist on going into speculations, they should buy their experience; and they are not fairly entitled to claim protection of the Legislature if sometimes they fall into the hands of persons who are more astute than themselves. A good deal of pity is (so at all events many people think) wasted on very undeserving objects; and I will ask you to remember this when you have to consider (if you ever do have to consider) any of the reforms which are now advocated in many quarters for checking abuses in connection with companies. It often happens that an attempt to check an abuse checks, not the abuse, but legitimate business. Projected reforms must be tackled very warily. Let me give you an example of the way in which reforms sometimes work. There have at various times been projects of legislation in this country in the direction of the enactment of provisions for increasing the liabilities and restricting the powers of directors. One of the Australian Colonies, probably with more time for legislation than the Imperial Parliament, has lately passed an Act framed on these lines. The effect, I am told, has been unfortunate. The better class of commercial men in the Colony shrink, so it appears, from becoming directors, having regard to the very onerous provisions of this new Act. They find that they are placing themselves under larger liabilities and restrictions than they are willing to undertake. You must remember that, where there is legislation of this kind, not only may directors find themselves under liabilities if they have done something wrong, but even if they have conducted themselves perfectly honourably they will always be open to attacks which, whether successful or not, may cause them great expense and trouble. I have mentioned this matter simply to draw attention to the dangers that may be produced by ill-advised attempts at reform. Modern commerce is exceedingly complicated; it is very difficult to trace cause and effect; and it is very dangerous to tamper with the

obscure laws which control the rise and fall of commerce, and are very imperfectly understood even by the deepest thinkers. I cannot help thinking that it would be well if those who are anxious to promote company reform would pay a little more attention to these facts. In certain directions stringency, no doubt, is very advisable, and in particular in the direction of the audit of company accounts. I believe that, in the Bill which is now before Parliament, provisions as to audit occupy an important place. One cannot help feeling that in almost all companies the audit cannot be conducted with too much care. A suggestion has sometimes been made which has excited a good deal of attention among persons interested in companies. The suggestion is that all companies should be forced to publish their balance sheets and file them with the Registrar of Joint Stock Companies. Commercial men, as a rule, have the greatest horror of publicity in connection with their accounts. In carrying on business, especially a manufacturing business, it is most pernicious, I am told, to give your trade rivals information as to which branch of your business is satisfactory and which is not. One cannot help feeling that if the Legislature makes it necessary that accounts should be published, a very serious blow will have been given to the prospects of the company system. As regards life assurance companies, there are already provisions in existence regulating the publication of accounts. The case of such companies differs materially from that of ordinary trading companies. I understand, however,—though on this matter I am scarcely qualified to speak before an audience of life assurance experts—that the existing regulations as to such accounts are not altogether satisfactory; and it may well be that in the details of these regulations, which you will find embodied mainly in the Schedules to the Life Assurance Companies Act of 1870, reform would be very advisable. Now as to reforms generally, let me say this, that the public often forget, and lawyers often forget even more than the public, that they hear much more about the fraudulent concerns than about the genuine concerns. I cannot help thinking myself that company reformers ought to have a little more trust in human nature than they sometimes seem to have. It may well be that the standard of commercial morality is not quite as high as moralists would wish; but on the other hand, in most classes of business, as a general rule,

the average commercial morality cannot be considered to be low, although it may not always rise to the ideals of the preacher or the philosopher; but I do not know that that could be expected.

Companies have sometimes been a good deal abused by commercial moralists on the ground that they have been so used as to enable a trader to trade without incurring any liability for his debts. You will have noticed that the scheme of the Companies Acts is that seven persons may form a company. The Act evidently aims at facilitating combination, and especially at facilitating trading combination with limited liability. But there is no magic in the number seven. Why should seven persons be allowed to trade with limited liability, and yet six not be allowed to have this advantage? As a matter of fact, the Acts have been used so as to enable a single man to trade with limited liability. One can trade with limited liability by the simple process of taking to himself six dummies and forming a company, in which he is the only real member. It is this kind of company which, no doubt, enables a man to trade without incurring personal responsibility for his debts. While it is perfectly true that this plan was not contemplated at the time the Act of 1862 was passed, I confess that I have always had very great difficulty in seeing anything in it contrary to the principles of commercial morality. It must be remembered that every one dealing with a "one man company," as such a company is called, has notice that the liability of the company is limited. It is difficult to see why it should be worse for a single man to trade without incurring responsibility for his debts than for twenty persons in combination to do the same thing. A short time since the legality of "one man companies" was questioned in the Law Courts; but it has now been definitely decided that there is nothing in the Companies Acts to forbid them.

The Companies Acts are, in the case of "one man companies," used, so I submit, for perfectly legitimate purposes. But incorporation under the Acts is sometimes sought for entirely illegitimate reasons. I will give you an example. There are certain Acts relating to chemists and to dentists which were passed with the object of preventing unqualified persons from entering into such businesses, but for some reason or other those Acts do not apply to companies, and that fact has been very

largely utilized by unqualified persons. The practice is for an unqualified person to form a company which he calls by some high-sounding name. He then proceeds to carry on his business under the name of the company without any of the qualifications which the Legislature has required of any ordinary chemist or dentist. That, I should say, is distinctly a fraud upon the Companies Acts, and probably measures will be taken to stop it very shortly. Then there is another rather serious use to which the Companies Acts have been put. I hardly like to call it fraudulent. As you may know, the death duties press very hardly upon certain classes of the community. Various ingenious schemes have been formed by which persons form themselves into a company with limited liability for the purpose of vesting their property in a company and dealing with the shares. The effect of this is supposed to be to give facilities for enabling the death duties to be avoided, or, at all events, for enabling their incidence to be met more easily. It is hard to call this fraudulent, because everyone is at liberty to arrange his business transactions in such a way as to avoid the exactions of the Inland Revenue, if he can, so long as he keeps within the law. There is nothing, strictly speaking, fraudulent in the transaction; but we may fairly take it that incorporation of that kind was not what was contemplated by the framers of the Acts.

This brings me to an end of the time which has been allotted to me to deal with the subject of these lectures. I will only detain you for one moment while I thank you very sincerely for the extreme kindness and attention with which you have listened to me. One cannot but feel that the law is a very large subject, and that company law is only one corner of it. In dealing with the whole subject, one could, perhaps, look at broad principles; but, when one is dealing with one corner of a subject, the principles are not so broad, and there is a great risk of losing one's self in a mass of somewhat technical detail. I can only hope that I may have been able to erect a few guide posts along your way, which may, perhaps, help you to tread, in your daily work, the somewhat intricate path of company law.

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